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Current Problems in Taxation

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THE HANDBOOK SERIES

SELECTED ARTICLES ON

CURRENT PROBLEMS IN TAXATION

COMPILED BY
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NEW YORK
THE H. W. WILSON COMPANY
LONDON : GRAFTON & CO.
1921

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PUBLISHED DECEMBER, 1921
Printed in the United States of America

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General Library
Trans.
10/28/58

EXPLANATORY NOTE

The tremendous burden of war debt that is now borne by our federal government, the interest on which must be met annually and the principal of which must be slowly paid off, makes the subject of taxation an important, even if an unpleasant, issue in our national affairs. In state and local matters taxation is also made an important question by the ever increasing demand for additional funds and by the loss of the revenue formerly obtained from the taxes on the liquor traffic. The pressing need of the states, and more particularly of the cities and other local governments, for increased revenue has been constantly growing more acute because modern progress demands of these governmental agencies more and better service.

Amazing and disheartening, under these conditions, are the evidences of misunderstanding of so vital public issues as the different phases of the taxation problem. One prominent business man testified before the Ways and Means Committee that he did not think that there was any such thing as a science of taxation! On another occasion a business man of prominence declared in a public address that all taxes are consumption taxes! In many pamphlets that have been widely distributed careful arguments are given to show that a certain proposed tax will be so "painless" that nobody will really notice it, but that it will yield between $3,000,000,000 and $5,000,000,000 of revenue each year; $150 a year from the average family and nobody notice it! We read in another pamphlet that a certain tax is so popular in the Philippines that "a revolution would occur if any attempt were made to repeal it!" A printed report by a state tax commission quotes at some length from Henry C. Adams's Public Finance and says that it is giving the words of Professor Thomas S. Adams of Yale. A report on federal taxation by a special committee of a great national organization of business men gives the "Four maxims of Adam Smith" but entirely omits the first and chief of his maxims. More amazing still were the revelations made a decade ago by Professor Seligman concerning the circumstances that surrounded the annulment by

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the United States Supreme Court of the federal income tax in 1895. (See Seligman, The Income Tax. Part II. Chapter 5)

These things show that to the group of vital problems concerning taxation there must be brought more earnest thought and study and more sincerity. Too long has taxation been a matter of indifference and unreasonable criticism. It is the purpose of this volume, like the other volumes of the Handbook series, to make information on a vital public question easily available by reproducing the best that has been written on each side.

In Part I is given some of the general principles of taxation. It deals especially with the question of apportionment and presents it in historical perspective. Part II deals with the proposed Sales Tax. Part III takes up the State Income Tax. In each part is a selected bibliography. In Parts II and III where debatable questions are considered, a brief is given on each side.

LAMAR T. BEMAN

October 1, 1921.

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INTRODUCTION

"It is nevertheless probably true that there is not, at the present time, a single existing tax decreed by despotism, or authorized by the representatives of the taxpayers, which has been primarily adopted or enacted with reference to any involved economic principles, or which has primarily sought to establish the largest practical conformity, under the existing circumstances, to what are acknowledged to be the fundamental principles of equity, justice, and rational liberty." These were not the rash words of any violent and unthinking radical in whose clouded mind, conscious of many social wrongs and personal misfortunes, were some vague ideas of a visionary scheme of taxation that would better the condition in life of the most unfortunate of mankind. They were the words of David A. Wells, one of America's foremost scholars and practical experts in taxation, a man who had prepared fifteen reports for the government of the United States, had served four years as special commissioner of revenue for the federal government, and was a member of the faculty at Yale.

Congressmen and legislators all too often follow the maxim of Colbert, that "The art of taxation consists in so plucking the goose as to procure the largest quantity of feathers with the least possible amount of hissing," rather than the classic maxims of Adam Smith or the enlightened discussions of later economists. They know that some classes make more hissing than others, and the frequency of elections all too often makes uppermost in their minds the matter of their own reelection.

In 1776, the year made famous by the adoption of the American Declaration of Independence, Adam Smith published his Inquiry into the Nature and Causes of the Wealth of Nations. In the following pages we quote from this great and epoch making work the four classic maxims concerning taxation and give some of the best of the later comment upon them by the ablest authorities of different generations. This

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and some of the more recent discussions of the general principles are given as the first part of this volume, to give the reader a foundation for the problems taken up in the second and third parts.

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DISCUSSION

ADAM SMITH'S FOUR MAXIMS[1]

The private revenue of individuals, it has been shown in the first book of this inquiry, arises ultimately from three different sources: rent, profit, and wages. Every tax must finally be paid from some one or other of those three different sorts of revenue, or from all of them indifferently. I shall endeavor to give the best account I can, first, of those taxes it is intended should fall upon rent; second, of those which it is intended should fall upon profit; third, of those which it is planned should fall upon wages; and, fourth, of those which it is intended should fall indifferently upon all those three different sources of private revenue. The particular consideration of each of these four different sorts of taxes will divide the second part of the present chapter into four articles, three of which will require several other subdivisions. Many of those taxes, it will appear from the following review, are not finally paid from the fund or source of revenue, upon which it was intended they should fall.

Before I enter upon the examination of particular taxes, it is necessary to premise the four following maxims with regard to taxes in general.

1. The subjects of every state ought to contribute toward the support of the government, as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state. The expense of government to the individuals of a great nation is like the expense of management to the joint tenants of a great estate, who are all obliged to contribute in proportion to their respective interests in the estate. In the observation or neglect of this maxim consists what is called the equality or inequality of taxation. Every tax, it must be observed, once for all, which falls finally upon one only of the three sorts of revenue above mentioned, is necessarily unequal,

[1] By Adam Smith. An Inquiry into the Nature and Causes of the Wealth of Nations. (1776). Book V, Chap. 1, Part 2.

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in so far as it does not affect the other two. In the following examination of different taxes I shall seldom take much further notice of this sort of inequality, but shall, in most cases, confine my observations to that inequality which is occasioned by a particular tax falling unequally even upon the particular sort of private revenue which is affected by it.

2. The tax which each individual is bound to pay, ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favors the corruption of an order of men who are naturally unpopular, even where they are neither insolent or corrupt. The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.

3. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it. A tax upon the rent of land or of houses, payable at the same term at which such rents are usually paid, is levied at the time when it is most likely to be convenient for the contributor to pay; or when he is most likely to have wherewithal to pay. Taxes upon such consumable goods as are articles of luxury, are all finally paid by the consumer, and generally in a manner that is very convenient for him. He pays them little by little, as he has occasion to buy the goods. As he is at liberty too, either to buy, or not to buy, as he pleases, it must be his own fault if he ever suffers any considerable inconvenience from such taxes.

4. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state. A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury, in the four following ways. First, the levying

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of it may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax, and whose perquisities may impose another additional tax upon the people. Second, it may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy, some of the funds which might enable them more easily to do so. Third, by the forfeitures and other penalties which those unfortunate individuals incur who attempt unsuccessfully to evade the tax, it may frequently ruin them, and thereby put an end to the benefit which the community might have received from the employment of their capitals. An injudicious tax offers a great temptation to smuggling. But the penalties of smuggling must rise in proportion to the temptation. The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it; and it commonly enhances the punishment, too, in proportion to the very circumstances which ought certainly to alleviate it, the temptation to commit the crime. Fourth, by subjecting the people to the frequent visits and the odious examination of the tax-gatherers, it may expose them to much unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expense, it is certainly equivalent to the expense at which every man would be willing to redeem himself from it. It is in some one or other of these four different ways that taxes are frequently so much more burdensome to the people than they are beneficial to the sovereign.

The evident justice and utility of the foregoing maxims have recommended them more or less to the attention of all nations. All nations have endeavored, to the best of their judgment, to render their taxes as equal as they could contrive; as certain, as convenient to the contributor, both in the time and in the mode of payment, and in proportion to the revenue which they brought to the prince, as little burdensome to the people. . . The following short review of some of the principal taxes which have taken place in different ages and countries will show that the endeavors of all nations have not in this respect been equally successful.

GENERAL PRINCIPLES OF TAXATION [1]

The qualities desirable, economically speaking, in a system of taxation, have been embodied by Adam Smith in four maxims or principles, which, having been generally concurred in by subsequent writers, may be said to have become classical, and this chapter cannot be better commenced than by quoting them.

* * *

The last three of these four maxims require little other explanation or illustration than is contained in the passage itself. How far any given tax conforms to, or conflicts with them, is a matter to be considered in the discussion of particular taxes. But the first of the four points, equality of taxation, requires to be more fully examined, being a thing often imperfectly understood, and on which many false notions have become, to a certain degree, accredited, through the absence of any definite principles of judgment in the popular mind.

For what reason ought equality to be the rule in matters of taxation? For the reason, that it ought to be so in all affairs of government. As a government ought to make no distinction of persons or classes in the strength of their claims on it, whatever sacrifices it requires from them should be made to bear as nearly as possible with the same pressure upon all, which it must be observed, is the mode by which least sacrifice is occasioned on the whole. If any one bears less than his fair share of the burden, some other person must suffer more than his share, and the alleviation to the one is not, *coeteris paribus,* so great a good to him, as the increased pressure upon the other is an evil. Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each person toward the expenses of government, so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his. This standard, like other standards of perfection, cannot be completely realized; but the first object in every practical discussion should be to know what perfection is.

There are persons, however, who are not content with the general principles of justice as a basis to ground a rule of

[1] By John Stuart Mill. Principles of Political Economy. (1848). Book 5. Chapter 2, sections 1-3.

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finance upon, but must have something, as they think, more specifically appropriate to the subject. What best pleases them is, to regard the taxes paid by each member of the community as an equivalent for value received, in the shape of service to himself; and they prefer to rest the justice of making each contribute in proportion to his means, upon the ground, that he, who has twice as much property to be protected, receives, on an accurate calculation, twice as much protection, and ought, on the principles of bargain and sale, to pay twice as much for it. Since, however, the assumption that government exists solely for the protection of property, is not one to be deliberately adhered to; some consistent adherents of *the quid pro quo* principle go on to observe, that protection being required for persons as well as property, and everybody's person receiving the same amount of protection, a poll tax of a fixed sum per head is a proper equivalent for this part of the benefits of government, while the remaining part, protection to property, should be paid for in proportion to property. There is in this adjustment a false air of nice adaptation, very acceptable to some minds. But in the first place, it is not admissable that the protection of persons and that of property are the sole purposes of government. The ends of government are as comprehensive as those of the social union. They consist of all the good, and all the immunity from evil, which the existence of government can be made, either directly or indirectly, to bestow. In the second place, the practice of setting definite values on things essentially indefinite, and making them a ground of practical conclusions, is peculiarly fertile in false views of social questions. It cannot be admitted, that to be protected in the ownership of ten times as much property, is to be ten times as much protected. Whether the labour and expense of the protection, or the feelings of the protected person, or any other definite thing be made the standard, there is no such proportion as the one supposed, nor any other definable proportion. If we wanted to estimate the degrees of benefit which different persons derive from the protection of government, we should have to consider who would suffer most if that protection were withdrawn; to which question if any answer could be made, it must be, that those would suffer most who were weakest in mind or body, either by nature or by position. Indeed, such persons would almost infallibly be slaves. If there were any justice, therefore,

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in the theory of justice now under consideration, those who are least capable of helping or defending themselves, being those to whom the protection of government is the most indispensable, ought to pay the greatest share of its price; the reverse of the true idea of distributive justice, which consists not in imitating but in redressing the inequalities and wrongs of nature.

Government must be regarded as so preeminently a concern of all, that to determine who are most interested in it is of no real importance. If a person or class of persons receive so small a share of the benefit as makes it necessary to raise the question, there is something else than taxation which is amiss, and the thing to be done is to remedy the defect, instead of recognizing it and making it a ground for demanding less taxes. As in a case of voluntary subscription for a purpose in which all are interested, all are thought to have done their part fairly when each has contributed according to his means, that is, has made an equal sacrifice for the common object; in like manner should this be the principle of compulsory contributions; and it is superfluous to look for a more ingenious or recondite ground to rest the principle upon.

Setting out, then, from the maxim that equal sacrifices ought to be demanded from all, we have next to inquire whether this is in fact done, by making each contribute the same percentage on his pecuniary means. Many persons maintain the negative, saying that a tenth part taken from a small income is a heavier burden than the same fraction deducted from one much larger; and on this is grounded the very popular scheme of what is called a graduated property tax, viz. an income tax in which the percentage rises with the amount of the income.

On the best consideration I am able to give to this question, it appears to me that the portion of truth which the doctrine contains, arises principally from the difference between a tax which can be saved from luxuries, and one which trenches, in ever so small degree, upon the necessaries of life. To take a thousand a year from the possessor of ten thousand, would not deprive him of anything really conducive either to the support or to the comfort of existence; and if such *would* be the effect of taking £5 from one whose income is £50, the sacrifice required from the last is not only greater than, but entirely incommensurable with, that imposed upon the first. The mode of adjusting

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these inequalities of pressure which seems to be the most equitable, is that recommended by Bentham, of leaving a certain minimum of income, sufficient to provide the necessaries of life, untaxed. Suppose £50 a year to be sufficient to provide the number of persons ordinarily supported from a single income, with the requisities of life and health, and with protection against habitual bodily suffering, but not with any indulgence. This then should be made the minimum, and incomes exceeding it should pay taxes not upon their whole amount, but upon the surplus. If the tax be 10 per cent, and income of £60 should be considered as a net income of £10, and charged with £1 a year, while an income of £1000 should be charged as one of £950. Each would then pay a fixed proportion, not of his whole means, but of his superfluities. An income not exceeding £50 should not be taxed at all, either directly or by taxes on necessaries; for as by supposition this is the smallest income which labour ought to be able to command, the government ought not to be a party to making it smaller. This arrangement however would constitute a reason, in addition to others which might be stated, for maintaining taxes on articles of luxury consumed by the poor. The immunity extended to the income required for necessaries, should depend on its being actually expended for that purpose; and the poor who, not having more than enough for necessaries, divert any part of it to indulgences, should like other people contribute their quota out of those indulgences to the expenses of the state.

The exemption in favour of the small incomes should not, I think, be stretched further than to the amount of income needful for life, health, and immunity from bodily pain. If £50 a year is sufficient (which may be doubted) for these purposes, an income of £100 a year would, as it seems to me, obtain all the relief it is entitled to, compared with one of £1000, by being taxed only on £50 of its amount. It may be said, indeed, that to take £100 from £1000 (even giving back £5) is a heavier impost than £1000 taken from £10,000 (giving back the same £5). But this doctrine seems to me too disputable altogether, and even if true at all, not true to a sufficient extent, to be made the foundation of any rule of taxation. Whether the person with £10,000 a year cares less for £1000 than the person with only £1000 a year cares for £100, and if so, how

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much less, does not appear to me capable of being decided with the degree of certainty on which a legislator or a financier ought to act.

Some, indeed, contend that the rule of proportional taxation bears harder upon the moderate than upon the large incomes, because the same proportional payment has more tendency in the former case than in the latter, to reduce the payer to a lower grade of social rank. The fact appears to me more than questionable. But even admitting it, I object to its being considered incumbent on government to shape its course by such considerations, or to recognize the notion that social importance is or can be determined by amount of expenditure. Government ought to set an example of rating all things at their true value, and riches, therefore, at the worth, for comfort or pleasure, of the things which they will buy; and ought not to sanction the vulgarity of prizing them for the pitiful vanity of being known to possess them, or the paltry shame of being suspected to be without them, the presiding motives of three-fourths of the expenditure of the middle classes. The sacrifices of real comfort or indulgence which government requires, it is bound to apportion among all persons with as much equality as possible; but their sacrifices of the imaginary dignity dependent on expense, it may spare itself the trouble of estimating.

Both in England and on the Continent a graduated property-tax (*l'impot progressif*) has been advocated, on the avowed ground that the state should use the instrument of taxation as a means of mitigating the inequalities of wealth. I am as desirous as any one, that means should be taken to diminish those inequalities, but not so as to relieve the prodigal at the expense of the prudent. To tax the larger incomes at a higher percentage than the smaller, is to lay a tax on industry and economy; to impose a penalty on people for having worked harder and saved more than their neighbors. It is not the fortunes which are earned, but those which are unearned, that it is for the public good to place under limitation. A just and wise legislation would abstain from holding out motives for dissipating rather than saving the earnings of honest exertion. Its impartiality between competitors would consist in endeavouring that they should all start fair, and not in hanging a weight upon the swift to diminish the distance between them and the slow. Many, indeed, fail with greater efforts than those with

which others succeed, not from difference of merits, but difference of opportunities; but if all were done which it would be in the power of a good government to do, by instruction and by legislation, to diminish this inequality of opportunities, the differences of fortune arising from people's own earnings could not justly give umbrage. With respect to the large fortunes acquired by gift or inheritance, the power of bequeathing is one of those privileges of property which are fit subjects for regulation on grounds of general expediency; and I have already suggested, as the most eligible mode of restraining the accumulation of large fortunes in the hands of those who have not earned them by exertion, a limitation of the amount which any one person should be permitted to acquire by gift, bequest, or inheritance. Apart from this, and from the proposal of Bentham (also discussed in a former chapter) that collateral inheritance *ab intestato* should cease, and the property escheat to the state, I conceive that inheritances and legacies, exceeding a certain amount, are highly proper subjects for taxation; and that the revenue from them should be as great as it can be made without giving rise to evasions, by donation *inter vivos* or concealment of property, such as it would be impossible adequately to check. The principle of graduation (as it is called) that is, of levying a larger percentage on a larger sum, though its application to general taxation would be in my opinion objectionable, seems to me both just and expedient as applied to legacy and inheritance duties.

The objection to a graduated property tax applies in an aggravated degree to the proposition of an exclusive tax on what is called "realized property," that is, property not forming a part of any capital engaged in business, or rather in business under the superintendence of the owner; as land, the public funds, money lent on mortgage, and shares (I presume) in joint stock companies. Except the proposal of applying a sponge to the national debt, no such palpable violation of common honesty has found sufficient support in this country, during the present generation, to be regarded as within the domain of discussion. It has not the palliation of a graduated property tax, that of laying the burden on those best able to bear it; for "realized property" includes the far larger portion of the provision made for those who are unable to work, and consists, in great part, of extremely small fractions. I can hardly con-

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ceive a more shameless pretension, than that the major part of the property of the country, that of merchants, manufacturers, farmers, and shopkeepers, should be exempted from its share of taxation; that these classes should only begin to pay their proportion after retiring from business, and if they never retire should be excused from it altogether. But even this does not give an adequate idea of the injustice of the proposition. The burden thus exclusively thrown on the owners of the smaller portion of the wealth of the community, would not even be a burden on that *class* of persons in perpetual succession, but would fall exclusively on those who happened to compose it when the tax was laid. As land and those particular securities would thenceforth yield a smaller net income, relatively to the general interest of capital and to the profits of trade; the balance would rectify itself by a permanent depreciation of those kinds of property. Future buyers would acquire land and securities at a reduction of price, equivalent to the peculiar tax, which tax they would, therefore, escape from paying; while the original possessors would remain burdened with it even after parting with the property, since they would have sold their land or securities at a loss of value equivalent to the fee-simple of the tax. Its imposition would thus be tantamount to the confiscation for public uses of a percentage of their property, equal to the percentage laid on their income by the tax. That such a proposition should find any favour, is a striking instance of the want of conscience in matters of taxation, resulting from the absence of any fixed principles in the public mind, and of any indication of a sense of justice on the subject in the general conduct of governments. Should the scheme ever enlist a large party in its support, the fact would indicate a laxity of pecuniarity integrity in national affairs, scarcely inferior to American repudiation.

PRINCIPLES OF TAXATION [1]

Adam Smith proposed four maxims, or principles, "which," says Mr. Mill, "having been generally concurred in by subsequent writers, may be said to have become classical." A vast deal of importance has been assigned by English economists to these maxims. They have been quoted over and over again, as if

[1] By Francis A. Walker. Political Economy. [1888]. p. 488-505.

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they contained truths of great moment; yet if one examines them, he finds them, at the best, trivial; while the first and most famous of these can not be subjected to the slightest test without going all to pieces.

The Social Dividend Theory of Taxation

"The subjects of every state," says Dr. Smith, "ought to contribute toward the support of the government as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."

This maxim, though it sounds fair, will not bear examination. What mean those last words, "under the protection of the state"? They are either irrelevant, or else they mean that the protection enjoyed affords the measure of the duty to contribute. But the doctrine that the members of the community ought to contribute in proportion to the benefits they derive from the protection of the state, or according as the services performed in their behalf cost less or cost more to the state, involves the grossest practical absurdities. Those who derive the greatest benefit from the protection of the state are the poor and the weak—women and children and the aged; the infirm, the ignorant, the indigent.

Even as among the well-to-do and wealthy classes of the community, does the protection enjoyed furnish a measure of the duty to contribute? If so, the richer the subject or citizen is, the less, proportionally, should he pay. A man who buys protection in large quantities should get it at wholesale prices, like the man who buys flour and meat by the car-load. Moreover, it costs the state less to collect a given amount from one taxpayer than from many.

Returning to the maxim of Dr. Smith, I ask, does it put forward ability to contribute, or protection enjoyed, as affording the true basis of taxation? Which? If both, on what principles and by what means are the two to be combined in practice?

Taxation According to Ability

But if we take the last six words as merely a half-conscious recognition of the social-dividend theory of taxation, and throw them aside, we shall still find this much-quoted maxim far from satisfactory: "The subjects of every state ought to contribute toward the support of the government as nearly as possible in

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proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy."

But is the ability of two persons to contribute necessarily in proportion to their respective revenues? Take the case of the head of a family having an income of $500 a year, of which $400 is absolutely essential to the maintenance of himself and wife and children in health and strength to labor. Is the ability of such a person, who has only $100 which could possibly be taken for public uses, one-half as great as that of another head of a family similarly situated in all respects except that his income amounts to $1000, and who has therefore $600 which could conceivably be brought under contribution? Manifestly not.

We shall, then, still further improve Dr. Smith's maxim if we cut away all after the first clause: "The subjects of every state ought to contribute toward the support of the government as nearly as possible in proportion to their respective abilities." The maxim as it stands is unexceptionable, but does not shed much light on the difficult question of assessment.

The Leave-them-as-you-find-them Rule of Taxation

The best statement I have met of the principle of contribution based on ability is contained in an article in the Edinburg Review of 1883: "No tax is a just tax unless it leaves individuals in the same relative condition in which it finds them." What does the precept, which we may call the leave-them-as-you-find-them rule of taxation, demand? In seeking an answer to this question, let us inquire, historically, what bases have been taken for assessment. Leaving out Rent-Bearing Land, whose fiscal relations have been sufficiently dwelt upon, we note four:

1. Contribution has been exacted on the basis of Realized Wealth, commonly spoken of as Capital.
2. On the basis of Annual Income, or Revenue.
3. On the basis of Faculty, or native and acquired power of production.
4. On the basis of Expenditure, or the individual consumption of wealth.

These are the four historical bases of taxation. Let us see how far each in turn answers the requirement of the Edinburgh Reviewer's maxim that the tax ought to leave the members of the community in the same relative condition in which it finds them.

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And, first, of Realized Wealth. Wealth is accumulated by savings out of revenue. If, then, wealth alone is to be taxed, it is saving, not production, which contributes to the support of the state. Economically there can not be a moment's doubt that for government thus to draw its revenue from only that part of the produced wealth of the community which is reserved from immediate expenditure, must be prejudicial. The question also arises, where is the political or social justice of such a rule of contribution? *If my income belongs to me, to spend for my own comfort and gratification, without any deduction for the uses of the state, why should I lose my right to any part of it because I save it?* To tax realized wealth is to punish men for not consuming their earnings as they receive them. Yet it is eminently for the public interest that men should save of their means to increase the capital of the country.

Revenue as the Basis of Taxation

Turning to Revenue, it would seem, on the first thought, that we had reached a rule of equitable contribution. Yet the rule of contribution according to revenue is subject to grave impeachment.

Here are two men of equal natural powers. One is active, energetic, industrious; he toils early and late and realizes a considerable revenue, on a portion of which the state lays its hand. The other lets his natural powers run to waste; trifles with life, lounges, hunts, fishes, gambles, and is content with a bare and mean subsistence. *Was his duty to contribute to the support of the state different in kind or degree from that of the other? If not, how has his idleness, shiftlessness, worthlessness, forfeited the state's right to a contribution from him in proportion to his abilities?*

We must, I think, conclude that, while to tax wealth instead of revenue is to put a premium upon self-indulgence in the expenditure of wealth for present enjoyment, to tax revenue instead of faculty is to put a premium upon self-indulgence in the form of indolence, the waste of opportunities, and the abuse of natural powers.

Expenditure as the Basis of Taxation

Passing, for the moment, by our third title, we find that the fourth basis taken for taxation has been Expenditure. This

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must not be confounded with taxes on consumption, as constituting a part of a tax system in which taxes on realized wealth, taxes on revenue, taxes on faculty, one or all of these, also appear. Nor do we speak here of taxes on expenditure imposed in practical despair of an equitable distribution of the burdens of government. We are now concerned with expenditure only as the single basis of taxation, in the interest of political equity.

"It is generally allowed," wrote Sir William Petty, two hundred years ago, "that men should contribute to the public charge but according to the share and interest they have in the public peace; that is, according to their estate or riches.

"Now, there are two sorts of riches, one actual and the other potential. A man is actually and truly rich according to what he eateth, drinketh, weareth, or in any other way really and actually enjoyeth. Others are but potentially and imaginatively rich, who, though they have power over much, make little use of it, these being *rather stewards and exchangers for the other sort than owners for themselves.*

"Concluding, therefore, that every man ought to contribute according to what he taketh to himself and actually enjoyeth, the first thing to be done is," etc., etc.

Arthur Young seems to have had the same view. After saying that every individual should contribute in proportion to his ability, he added in a note: "By ability must not be understood either capital or income, but that superlucration, as Davenant called it, which melts into consumption."

In this view, so far as any one possesses wealth in forms available for the future production of wealth, he is regarded as a trustee or guardian, in that respect and to that extent, of the public interests. Just this is said by Young—taxes "can reach with propriety the expenses of his living only. If they touch any other part of his expenditure, they deprive him of *those tools that are working the business of the state.*"

Fallacy of this Doctrine

I do not see but that, if capital, or revenue in excess of personal expenditure, is to be exempted from taxation, on the plea that it has not yet become the subject of individual and exclusive appropriation, and is, therefore, presumably held and used in a way which primarily benefits society, the state has the

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right to inquire whether the use made or proposed to be made of wealth is such as will, in fact, benefit society, and benefit society, moreover, in the highest degree of which it is capable.

The citizen says to the state, "You must not tax this wealth because I have not yet appropriated it exclusively to myself. Indeed, I am going to use it for the benefit of society." The state rejoins: "Yes, but of that we must satisfy ourselves. We must be the judge whether your use of your wealth will benefit society. Pay your taxes, and you can do with your wealth as you like. Claim exemption on the ground of public service, and you rightfully come under state supervision and control."

The fallacy of the theory we are considering lies in the failure to recognize the fact that the selfish and exclusive appropriation and enjoyment of wealth are inseparable from its possession. The pride of ownership, the social distinction which attends great possessions, the power which wealth confers, are additional to the merely sensual enjoyment to be derived from personal expenditure. Would I resent the interference of the government, or of my neighbors, in the management of my property, upon the ground that it was not being used in the best way? What is that resentment but the proof of a personal appropriation, an exclusive appropriation, of that wealth? My resentment would spring out of the deeply seated feeling that my management of my own property is my right: and that he who should deprive me of it would take from me what is as truly mine as the right to eat, drink, wear, or otherwise consume and enjoy any portion of it; that, short of absolute mental incapacity, it is my prerogative to control my own estate, even though not to the highest advantage of the community, or even of myself: though not wisely or well. In other words, I am not a trustee, but a proprietor.

Dangerous Nature of This Doctrine

This doctrine of the Trusteeship of Capital is not more irrational than it is socially dangerous. It is held by men who are fierce in denouncing graded taxation as confiscation; yet it is, in its very essence, communistic. If the owner of wealth is but a trustee; if "his tools are working the business of the state," then the real beneficiary may enter and dispossess the trustee if any substantial reason for dissatisfaction as to the

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management of the property exists; the state may take the tools into its own hands and "work its business" for itself.

Faculty as the Basis of Taxation

I reach, then, the conclusion that Faculty, the power of production, constitutes the only theoretically just basis of contribution; that men are bound to serve the state in the degree in which they have the ability to serve themselves.

I think we shall more clearly see Faculty to be the true natural basis of taxation if we contemplate a primitive community, where occupations are few, industries simple, realized wealth at a minimum, the members of the society nearly on a level, the wants of the state limited. Suppose, now, a work of general concern, perhaps of vital importance, requires to be constructed: a dyke against inundation, or a road, with occasional bridges, for communication with neighboring settlements. What would be the rule of contribution? Why, that all able-bodied persons should turn out and each man work according to his faculties, in the exact way in which he could be most useful.

In regard to a community thus for the time engaged, we note two things: first, no man would be held to be exempt because he took no interest in the work; he would not be allowed to escape contribution because he was willing to relinquish his share of the benefits to be derived, preferring to get a miserable subsistence for himself by hunting or fishing; second, between those working, a higher order of faculties, greater muscular power, or superior skill would make no distinction as to the time for which the individuals of the community should severally remain at work.

The Ideal Tax

This is the ideal tax. It is the form of contribution to which all primitive communities instinctively resort. It is the tax which but for purely practical difficulties, would afford a perfectly satisfactory measure of the obligation of every citizen to contribute to the sustentation and defense of the state. Any mode of taxation which departs in essence from this involves a greater or smaller sacrifice of the equities of contribution; and any mode of taxation which departs from this in form is almost certain to involve a greater or smaller departure in essence.

And it deserves to be noted that the largest tax of modern

times, even in the most highly organized societies of Europe, the obligation of compulsory military service, is assessed and collected on precisely this principle.

Faculty Tax Impracticable

But while the tax on Faculty is the ideal tax, it has usually been deemed impracticable, as the sole tax, in a complicated condition of industrial society. As occupations multiply and the forms of production become diversified, the state can not to advantage call upon each member, by turns, to serve in person for a definite portion of each day or of the year. Hence modern statesmanship has invented taxes on expenditure, on revenue, on capital, not as theoretically just, but with a view to reduce the aggregate burden on the community, and to save production and trade from vexation and obstruction.

We recur to the Tax on Revenue

The politicians of the existing [1888] order, as we have seen, shrink from the effort involved in levying the public contributions entirely, or even chiefly, according to faculty. Next in point of political equity comes the tax on incomes, or the revenues of individuals. That tax, as we now contemplate it, is a tax on the revenues of all classes, with exception only of the amount requisite for the maintenance of the laborer and his family, after the simplest possible manner, in health and strength to labor. It is not a compensatory tax, constituting a part of a system in which realized wealth and various forms of expenditure are also brought under contribution, but the sole tax imposed by the state.

Exemption of the Actual Necessaries of Life

It has been said that from such an income tax the necessary cost of subsistence must be exempted. Mr. D. A. Wells has, indeed, laid down two propositions: first, that "any income tax which permits of any exemption whatever is a graduated income tax;" and second, that "a graduated income tax to the extent of its discrimination is an act of confiscation." But the exemption of a certain minimum annual revenue is a matter of sheer necessity, whether the state will or no. Economically speaking, it is not possible to tax an income of this class. A man in the receipt of such an income cannot contribute to the

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expenses of government. Should the state, with one hand, take any thing from such a person as a taxpayer, it must, with the other, give it back to him as a pauper.

THE PRINCIPLE OF APPORTIONMENT[1]

The question of apportionment of taxes leads to a consideration of the relative duty of citizens to pay for the support of the state. The student is not left entirely to speculation respecting this subject. As has been already pointed out, it lies in the nature of a tax, and of the political conditions in which taxation presents itself as an important public problem, that payments for support of the state should be equitable as between citizens. The principle of apportionment, therefore, according to which this duty is assigned, must recognize all those complex relationships which modern philosophy finds in the phrase political equity.

Special Reasons for Equitable Apportionment

No argument is needed to enforce the conviction that taxes should be apportioned on the basis of equity, but a few words may be added to render yet clearer the nature of this necessity. The power to tax is a sovereign power, and its exercise should be equitable for the same reason that every act of government should conform to what is fair and just.[2] Now that the personal sovereign is no longer a menace to the rights of the people, the importance of relative justice as between citizens is the strongest apology for popular government. This demand for equity, therefore, finds its ultimate sanction in the structure of the state itself, and when used in connection with taxation it is merely an application to a specific case of a fundamental conception respecting popular government.

It is possible, however, to discover a more commonplace reason for an equitable distribution of payments. Taxes are frequently spoken of as burdens, and there is no objection to such a use of language, provided the phrase is employed in the same sense as when speaking of any of the necessary items of expenditure in the domestic budget. If the payment of a

[1] By Henry C. Adams. The Science of Finance. p. 321-32.
[2] The student of course recognizes this as coming from Mill.

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coal bill or the quarter's rent be a burden, then is the payment of a tax a burden. Using the phrase in this sense it is clear that the payment of any definite amount, the various expectations from life due to a customary standard of living being for the moment dropped from view, is felt to be a burden in proportion to the size of the fund from which it is made. The burden of a payment is measured by what is left after the payment, rather than by the amount paid. It is the surplus over the necessary expenditures of life which minister to the developing, and therefore the most keenly sensitive, wants. This is the explanation of the universal opinion that where fortunes vary equal payments would not be equitable as between citizens; and the commonplace argument for equity in matters of taxation, to which reference was made, rests upon the assumption that the relief to him who fails to pay his just share is not as great as the burden which this relief imposes on some other member of the community who on this account pays more. Equity in the apportionment of taxes, therefore, reduces the burden for the support of the State to its minimum, just as a scientific adjustment of straps and buckles by which a knapsack is slung to a soldier's back makes the load carried as though it were light.[1] It thus appears that a just system of taxation is equivalent to economy of social energy, from which it follows that the principle according to which taxes are apportioned may have a very direct bearing upon the rate of social development.

The above thought may be pressed yet a step further by showing more specifically how equity in the levy of taxes bears upon the development of a nation's industries. A payment of any sort works its way into industrial conduct through the incentives to industry resulting from the satisfaction which follows the payment in question. The labour which will be undertaken in the future depends in large measure upon the degree of satisfaction resulting from the labour of the past. This, tempered, perhaps, by the instinctive hopefulness of mankind, is the fundamental law of industrial conduct. Is it not, then, clear that an inequitable apportionment of taxes, which deprives him who pays too much of more satisfaction in the expenditure of his income than it adds to that of him who pays too little, results in weakening the aggregate of

[1] A common simile of German writers.

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the motives to industrial activity? Thus the universal experience of nations, that one of the surest ways to encourage industry is to adjust the fiscal system to the demands of equity as between citizens, finds upon analysis a psychological basis.

There are, then, three reasons why equity should control apportionment. It is demanded by the accepted governmental principles of free states; it is essential to the economy of social energy; and it is important as a means of presenting motives to industry in the most effective manner.

Analysis of the Rules of Apportionment

It is one thing to conclude that equity should give character to apportionment; it is quite another to discover an intelligent and at the same a workable rule for the attainment of this end. Some progress in this direction was made when considering the theorist's definition of a tax, since it was there shown that a tax could be considered neither as the price charged for public service nor as an equivalent paid for value received. On the other hand, it was concluded that a tax is a contribution to a common fund designed for a common end. Manifestly, the principle of apportionment adopted will ally itself to the accepted conception of a tax; and we might, therefore, in strict logic, proceed at once to inquire what theory of apportionment is bound up in the statement that a tax is a contribution. This, however, would exclude certain considerations capable of throwing considerable light upon a difficult problem. It would also result in an opinion arrived at from theory alone, ignoring those practical considerations which so largely control in matters of finance, and which do not present themselves until one begins to trace the consequences that follow the application of the principles adopted.

Apportionment and the Cost Theory of Taxation

A moment's consideration is adequate to show that the duty to pay for the support of the state cannot be assigned to citizens according to the cost to government of the service rendered. The fact that this cost cannot be specialized is of itself final against such a rule. Protection, for example, consists in creating and maintaining a condition of security in society, and its cost cannot be divided up and parcelled out. The law undertakes to arrest and punish every criminal, no matter what the cost

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may be, neither as an act of retribution nor to enable him who suffered the wrong to enjoy revenge, but because every miscarriage of the law tends to destroy the conditions under which life is secure. "The value of government to any man is proportioned to the completeness of the protection it extends to all men. If it undertook to protect only those who contribute to its cost, it would thereby breed lawlessness and invite anarchy." [1]

The error underlying the rule that taxes should be apportioned to cost is further shown by applying it to the protection of property. All property is not of the same sort in that its protection does not occasion the same expenditure. More litigation, for example, arises respecting property that exists in the form of a patent privilege, a franchise, or any sort of a grant whatever, than is the case respecting property open for investment to all who possess free capital. The state could not, however, on this account impose heavier burdens upon it than upon ordinary property. A better illustration may be given: security of property depends in large measure upon the enlightened self-interest and moral sense of the community in which it exists. Where the grade of intelligence is low the cost of protection is high; where the grade of intelligence is high the cost of protection is low; but, provided two such communities have intercourse with each other, it is of as much importance to the community where property is secure that property be protected in the community where it is exposed to danger, as that its own property should be guarded. Here, again, as in the case of protection to life and limb, the end of government is to maintain a condition of security, and it is easy to see that the protection of property on the borderland of attack is essential to the security of that which on account of its situation is relatively less exposed. The rule of apportioning taxes according to cost is not capable of realization.

Moreover, the theory on which it rests fails to harmonize with one's ideas of equity and justice as between different classes of property differently located. It is not fair that property which already carries a burden on account of the fact that from its nature or condition it is insecure should be imposed with unusual taxes, when its protection is essential to the security of all property in the community. To apply the

[1] By Cooley. Principles That Should Govern in the Framing of Tax Laws. p. 5.

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principle of cost in the levy of taxes would be to call for heavy payments from the weak in order to render small the payments from the strong; and since the payment is a coerced and not a voluntary payment, such an assignment of the duty to support the state cannot be regarded as equitable employment of public authority.

No government, so far as the writer is aware, undertakes to apply strictly the rule of apportionment now under consideration. But there are many instances in which the principle of cost is permitted to shape in a very marked degree financial policy. Indeed, a survey of the taxing system of modern states offer some warrant for the generalization that according as a people has emerged from feudalism at a remote or recent date, so will be the extent to which taxes are apportioned on the basis of cost. In England at least, where feudalism was abandoned in the sixteenth century, very little is known of the specialization of public services; while German peoples, from whose administrative *régime* the influence of feudalism has not yet passed away, consciously recognize the rule that payment for the support of the state should be adjusted to cost. The classifications of service which permits the theory of specialization to be realized are both interesting and instructive. The one here given is taken from the Austrian writer, von Hock. According to von Hock the services of the state are regarded as embraced under three classes, as follows:

First. Every one who acknowledges himself as a loyal subject of the government enjoys from the state protection of person, the care of the state for safety, and for the preservation of general order, for cleanliness, and freedom from disease; he enjoys also the dignity and sense of importance which comes with the strength and reputation of a nation, and avails himself also of the privilege of carrying on an industry, trade, or profession within the state which would not be possible except the state exists. These and other like services are personal and direct. They are rendered to rich and poor alike, and should on this account be made the basis of the personal tax.

Second. Whoever has possessions in a state and invests his property in an industrial calling enjoys the protection of the state for his property and his industry; the courts enforce legitimate contracts and guard him against all fraudulent

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procedures; he enjoys the advance in the value of property that accrues on account of the growth of society; or, without further specification, reducing all these services to a common basis, each citizen enjoys a given income under the protection of the state and in part because the state exists. This class of services is made the basis of the income or property tax.

Third. In addition to the above there are a large number of special and peculiar services which the state renders to individuals. Public education, the building of highways, the transmission of news, the conferring of honours, the recording of mortgages, and the like, are illustrations of the services in question. Being special in their character, they should, according to the purchase theory of taxation, be made the basis of a special payment.[1]

Should one insist on proceding from the *quid pro quo* theory of taxation he probably could not find a better classification of public services for that purpose; a good classification, however, does not set aside the errors in theory or the difficulties in administration incident to this conception of taxation.

Apportionment and the Benefit Theory of Taxation

It has also been the claim of many writers that taxes should be apportioned on the basis of the value of services to citizens. This is the principle of apportionment corresponding to the benefit theory of a tax. Among the practical results of an attempt to apply the value theory of apportionment would be the imposition of excessive taxes upon those who are least able to support them. It is undoubtedly true that the guardianship of a just government is appreciated most intensely by those who are least capable of protecting themselves. As stated by President Walker, "those who derive the greatest benefit from the protection of the State are the poor and the weak—women and children, and the aged; the infirm, the ignorant, the indigent."[2] Not only is this true of the original and fundamental functions of government, that is to say, the protection of life and property, but it is equally true, indeed in a more marked degree true, of the higher activities of later appearance, such as education, recreation, guardianship against the deteriorating influence of unregulated competition, and the

[1] Die oeffentlichen Abgaben und Schulden. p. 15-16.
[2] Political Economy. p. 490.

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like. It thus becomes clear that to apply the principle that taxes should be paid in proportion to the value of service would destroy the conditions which alone justified the state in undertaking the service in the first place. If taxes for the support of schools, for example, should be levied to citizens in proportion to the value to them respectively of the public-school system, as estimated by citizens of varying incomes, no sound reason could be urged why the state should undertake to provide public schools at all. It is because the education which the rich will naturally provide for their children may, with a very slight addition to the cost, be made the common possession of all classes that the state assumes the support of schools. It may be urged that the poor should pay for the increment of cost arising from the extension of facilities for instruction; but to call upon them for payment in proportion to their estimate of the value to them of a system of free schools is a *reductio ad absurdum*. It would cause the schools to disappear, yet this is what the benefit theory of taxation logically applied would lead to.

The theory of apportionment now claiming attention will be recognized as unsound if, in addition to noting its practical results, one observes that it calls for an estimate of what is beyond estimate or for which there is no comparative basis of estimate. Government is essential to civilized existence and there is, therefore, no basis for calculating the value of the services which it renders. "If government," says Judge Cooley, "were something to be taken up or dispensed with at the option of individuals, that method of estimation would take on a different appearance; but when the existence of a government in some form is confessedly something always to be assumed, it is clear that there can be no basis for an estimate of its value as compared with that condition of things in which there should be no government at all. It is true that if a theory valuable for practical application can be deduced from any imaginary state of things, there is no reason in the baselessness of the assumed facts to preclude our availing ourselves of it. The theory that government is founded in contract may answer a good purpose, though historically it is baseless. But so long as it is impossible to estimate the relative value of government to person and property, and impossible to collect taxes according to it if the estimate were practicable, it is manifest that any theory of

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taxation drawn from an impossible comparison of a state of society under settled government with an imaginary state of things when no government exists must be absolutely without practical value." [1]

Apportionment and the Contributory Theory of Taxation

It is hoped that the foregoing considerations have served to impress upon the reader the conception of solidarity in modern society, and of common interests which do not admit of segregation either as a cost to the government or a value to the citizen; for it is under the influence of this conception that the true theory of apportionment must be developed. A tax is a contribution from private funds to the public purse, and the principle according to which the government should determine for each the amount of his contribution is found in the expression that each citizen should pay for the support of the state in proportion to his ability as compared with the ability of others.

Should one ask why ability is accepted as the basis of apportionment, perhaps the most satisfactory reply would be that it approves itself to the moral sense of men in all cases where common expenditures are met by means of contributions. A church, for example, in which the sense of duty in the matter of payments is more highly developed than in any other voluntary association holds it as a common law of religious sentiment that the rich member should pay more for common ends than the poor member; and the measure of his greater payment is his ability, all things considered, to bear the payment. This is the New Testament doctrine of service, and its acceptance as a canon of taxation shows that the modern science of finance recognizes one of the fundamental principles of Christian ethics. Not alone in the church is this rule of service recognized, but in all voluntary associations, whether temporary or permanent, it is admitted as a principle of action, provided only the association acknowledges a solidarity in the interests of its members. [2] It may, then, be asserted without further comment that

[1] By Cooley. Principles that should Govern in the Framing of Tax Laws. p. 4.

[2] A club with annual fees does not commonly realize solidarity of interest. Should this however be the case in some particular instance, a club would still have no need to recognize ability of members in securing means for pecuniary support, since its members are all of the same class and consequently equal payment for club expenses becomes equitable payment as between club members.

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the rule of apportionment which calls for the levy of taxes according to the ability of citizens to pay finds its sanction in the moral sense of the community, and this in all matters of social rights and social duties must be accepted as final.

The inquiry may perhaps be raised, in view of the fact that the contributory theory of a tax was not granted approval until comparatively recent times, whether modern peoples are influenced by finer conceptions of justice and equity than was the case in the past. This may possibly be true, but the acceptance of the principle that taxes should be levied according to ability, in place of the "cost" or the "benefit" theory of apportionment, does not prove it to be true; inasmuch as a consideration of the social and industrial conditions under which these abandoned theories were held will show that they were capable at the time of securing substantial justice as between citizens.

Consider, for example, the rule upon which the colonial taxation of Massachusetts rested. "Every man's life," it was asserted, "is equally dear to him, and every man should pay equally for its protection; every man's property is equally dear to him, and every man should pay for its protection in proportion to its amount." The society which this rule held in view was early New England society, and the time the last part of the last century. There was at this time a rough equality in respect to property as well as social status, and on this account the principle of apportionment to which Massachusetts statesmen gave their approval would lead to payment for the support of the State in proportion to ability. The same rule applied at the present time would not result in adjusting the burden of taxation in proportion to the relative ability of citizens. It is the new social and industrial conditions which make it necessary to abandon the "cost" and the "value" theories of apportionment, and not the development of a finer sense of justice among men. It is true that a higher phase of social ethics is in process of evolution, and that the necessity of giving expression to the contributory theory of taxation is one of the results of that evolution, but to claim that payment for the support of the state in proportion to ability is a newly developed moral concept would be to cast suspicion upon the rule of apportionment for which we are now contending. It is much more convincing to say—what, indeed, is true—that the equity of the rule that taxes should be paid in proportion to ability has been universally

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approved by the moral sense of mankind, but that never until recently has there been any need for the formal expression of the rule as the basis of apportionment. It is the complex character of modern industry, its stratification along the line of property rights, and the great disparity of riches, which brings into prominence the principle that taxes should be paid according to ability. Not only, therefore, does this theory of apportionment rest upon the moral sense of the community as it now exists, but it appeals for support to the conscience of the past. The first struggle which arose respecting taxation was to establish the rule that all men should pay something; the question of the present is to devise a system by which men may be made to pay according to their abilities.

One further thought may be expressed with regard to the principle of apportionment now under consideration. It finds an added sanction in the fact that it is the complement of the theory of distribution which both individualistic and socialistic economic philosophy recognizes as just and equitable. Communists assert that product should be distributed according to need; all other schools of writers claim that product should be distributed according to efficiency. If, now, the product of the industrial organization is to be distributed according to efficiency, what is more natural than that the payment for the support of the state, which alone renders industrial association possible, should be made according to ability? The financial principle of apportionment according to ability is thus observed to be the counterpart of the economic principle of distribution according to efficiency. Whether or not the financial principle would fall were the economic principle to be abandoned need not here be discussed; it is sufficient to notice the close connection which exists between the principle of public and of private economy, and to recognize that each receives a presumption in its favour from the acceptance of the other.

It is believed that the above considerations warrant the conclusion that equity in taxation means the assignment to citizens of their duty to support the state in proportion to their respective abilities. This is by no means a simple conception, as will be shown by the analysis which follows, which has for its purpose to discover in what manner the ability of the citizens to pay for the support of the state may be determined. The point at issue in this analysis is the following:

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Is ability measured by the amount of property a man possesses or the income he enjoys, or does it increase at a rate more rapid than the increase in his property or his income? Does payment according to ability demand the acceptance of the proportional or of the progressive principle in the apportionment of taxes? The modern tendency, as shown by tax reforms during the past twenty years, is toward greater reliance on the progressive principle; [1] that, however, does not prove the principle to be a sound one, although it may raise a presumption in its favour. The question as thus presented calls for careful analysis.

THE FUNDAMENTAL PROBLEMS [2]

Amid the clashing of divergent interests and the endeavor of each social class to roll off the burden of taxation on some other class, we discern the slow and laborious growth of standards of justice in taxation, and the attempt on the part of the community as a whole to realize this justice. The history of finance, in other words, shows the evolution of the principle of faculty or ability to pay—the principle that each individual should be held to help the state in proportion to his ability to help himself.

Premising a general acquaintance with the main lines of fiscal evolution, what interests us here is the tracing of the fundamental ideas on which the evolution was based. In other words, taking it for granted—what indeed cannot fail to be granted, after a study of the facts—that there has been a progressive attempt to realize the demands of fiscal justice and a more or less unconscious tendency to work out the principle of ability to pay, the question presents itself as to what are the historic forms of the test of this ability. Granted that in some more or less rough way an endeavor is made, almost from the beginning, to apportion public burdens in accordance with the presumed capacity of individuals or classes, the problem arises as to how the capacity to bear this burden is to be measured. Even where it is difficult to recognize any conscious attempt

[1] Seligman's chapter on "Recent Reforms in Taxation" in Essays in Taxation.

[2] By Edwin R. A. Seligman. The Income Tax. p. 4-18.

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on the part of government to carry this principle into practice, and even where actual fiscal institutions represent more or less thinly disguised efforts of the dominant economic class to roll the burdens on the shoulders of the weak,—even here it is rare to find a cynical disregard of all consideration of equity; and even here a more or less successful effort is made to clothe the hard facts of economic oppression in the garb of some specious explanation. Thus, whether it be actually realized or not, it is possible to interpret the successive stages of fiscal development in terms of an attempt to enforce various criteria of ability to pay.

From this point of view, namely that of the norm or test of faculty, it may be said that no less than five answers have been given in the course of history. At the outset, the individual as such was selected as the norm. Mere numbers suffice in primitive society to answer the requirements of justice. Thus it is that everywhere the beginnings of direct taxation take the form of the poll or capitation tax. In a primitive community where private property has but slightly developed or where the differentiation in economic conditions is insignificant, where there are no very rich and no very poor, where every man works and where individual revenue is derived almost exclusively from individual exertion, it is indeed true that polls form an approximately satisfactory test of ability in taxation. Wherever we have primitive economic and democratic conditions, whether it be in the early stages of Teutonic civilization or in the beginnings of Puritan New England, we find that the poll tax forms an essential ingredient of the fiscal system.

With the development of private property, however, and with the differentiation of economic classes, a change sets in. The original equality of wealth is followed by an inequality of possessions. The distribution of ownership, in other words, is now gradually divorced from the mere accumulation of numbers. A poll tax responds less and less well to the demands of faculty until it finally becomes, at all events as the sole test of ability, almost wholly a mockery. Efforts may indeed be made to improve the situation for a time by graduating the poll tax according to outward signs so that the poll tax in some cases becomes a class tax, the assessment being graded roughly in accordance with the social position of the individual. But

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this class or classified poll tax, as we find it in the early Middle Ages, is only a makeshift, and before long the poll tax is either supplemented or supplanted by a property tax.

Property as the Test of Faculty

In this second stage of development, property is accepted as the test of faculty in taxation. For many centuries it forms an admirable test. Amid the rude conditions of ownership that we find at this stage of economic life, private property consists very largely of land and of appurtenances to land, so that the property tax is virtually a tax on real estate. Gradually, as primitive industry and commerce develop, various forms of personal property come into prominence and are added to the tax lists, until finally the two elements are fused together in order to form the general property tax, which is universally found in this sage of economic development. Property becomes the only possible general test of faculty in taxation because it is the specific mark of distinction between classes and between individuals within each class. At first the property tax is shyly and cautiously added to the poll tax, as an unimportant feature of the system; then the property tax grows in significance while the poll tax slowly recedes; until finally the poll tax disappears and the property tax remains in possession of the field. The general property tax is found wherever a primitive democracy is accomplished by a moderate agricultural and commercial development.

For a long time the general property tax functions satisfactorily and responds fairly well to the canons of justice in taxation. But in the inevitable course of economic development, with the growing differentiation of economic classes and with the increasing complexity of economic life, certain difficulties make themselves felt, not only in the practical application of the system but also in the theoretical basis of the tax. With the practical difficulties of the system, this is not the place to deal. The causes of the breakdown of the general property tax and the reasons why it everywhere disappeared in the later Middle Ages in Europe and why it is beginning to disappear in its last stronghold—the United States—have been sufficiently expounded elsewhere.[1] What interests us in this place is the

[1] See Seligman. Essays in Taxation. Chap. II.

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theoretical shortcomings of property as a test of faculty in taxation.

These shortcomings may be summarized as follows: In the first place, a gap often discloses itself between property and product. It is indeed true that in the long run the value of a piece of property stands in a close relation to its yield. To use a modern phrase that has become familiar, capital is nothing but capitalized income. That is to say, what a piece of property will fetch in the market represents nothing but a capitalization of its present and prospective yield. While this is, however, true in the long run, it is not true in the short run. The value of a piece of property may bear only a slight relation, or no relation at all, to the yield of that property in any particular year, or even for a term of years. Two farmers may possess homesteads of equal value. The one may have bad luck and suffer drought or inundation, while the other may enjoy a bountiful harvest. With property as a test of faculty, the two farmers will pay the same, although the produce of their farms may differ enormously. Again, of two house owners desiring to rent their property, one may succeed and the other may fail for the year, or for a term of years. Although the unsuccessful owner has no income, he must, with property as the test of faculty, pay the same amount as the other. Instances might be multiplied, all tending to show that property and product may frequently diverge.

In the second place, a distinction is gradually observable between property incomes and labor incomes. In the early stages of the development, where property owners bear the greater part of the public burdens, the man who has no property either is reached by the poll tax, or is of such slight taxable capacity that he is entirely omitted. In modern times, however, with the growth of lucrative professions and with the great opportunities for rich salaried positions, labor incomes assume an importance which did not exist in earlier times. It may well be granted that the recipient of a modest salary should be put on a different plane from the individual who receives a like income from invested property; but that is a different thing from claiming that lawyers or doctors or engineers or railway presidents with salaries or professional earnings of from $25,000 to $100,000 a year should not be called upon to contribute at all

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to the public charges. The acceptance of property as the sole test of ability to pay would result in a complete exemption of such classes, and would give rise to countless well-founded complaints.

In the third place, the recognition of property as the test of ability to pay raises a difficulty connected with indebtedness. There is a well-defined distinction between the legal and the economic conceptions of property. By property in the legal sense is meant the ownership of individuals in things or in rights to things, irrespective of the ulterior division of the produce of the property. By property in the economic sense—usually denominated wealth—is meant the control of the services of the thing possessed. If a part of the services or produce has to be handed over by the individual to some one else, it does not really form a part of his wealth. The owner of a $10,000 farm who has mortgaged it for $5,000 possesses wealth, or property in the economic sense, to the extent of $5,000. That wealth represents the amount that he is worth. His debts are a part not of his assets, but of his liabilities, and must be deducted from the assets in order to strike a correct balance sheet. Legally, however,—at all events under the modern law of mortgage—his property amounts to $10,000. If the government, as is usually the case, looks at the piece of property rather than at the individual condition of the property owner, it will assess the taxpayer on the full $10,000. In other words, in a property tax the expenses incurred in maintaining the property are ordinarily not considered.

This insistence upon the legal rather than the economic conception of property dates from the period when virtually all existing credit consisted of consumption credit rather than production credit and when indebtedness played a very small rôle in the social economy. In modern times, however, credit has become the very basis of business enterprise. Under these circumstances the problem of indebtedness assumes a new significance. It was but natural, therefore, that the property tax, where it still existed, should take some account of this new condition and should endeavor to make allowance for debts. But experience soon showed that this attempt was fraught with great practical difficulties. As we have seen in the United States, the creation of fictitious debts became such a paying investment that most of the states which introduced the system were com-

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pelled again to abolish it. As a consequence, some states today deduct mortgage debts from real estate; others deduct general indebtedness from personal estate; a few permit deduction for indebtedness in general; while most of the states allow either for no deduction at all, or for deduction in only personal or real estate. Such a situation is bound to be unsatisfactory.

In the fourth place, property as a test of faculty fails to draw the correct distinction between the constituent elements of wealth. In former times, when property was scanty and almost entirely used for productive purposes, the situation was simple. But in modern times a sharp line must be drawn between consumption property and productive capital, between property utilized primarily for purposes of enjoyment and property utilized for the securing of a money income. Take as an example of the first case a private library or art gallery or park which, instead of being the source of a money income, is really the occasion of a distinct expenditure. To put such things on the same footing as property which yields a money income is, to say the least, a procedure open to grave doubt. To tax property as a unit, irrespective of the kind of property or the income from the property or the outlay connected with the property, becomes in modern times a source of increasing embarrassment.

Finally, in the fifth place, the history of the general property tax has everywhere shown that there seem to be insuperable difficulties in reaching the multifold forms of wealth in a developed industrial society. It is everywhere conceded that universality of taxation is one of the leading fiscal principles; yet the growing difficulties of reaching all the different forms of property inevitably lead to the escape of some and to the over-assessment of others. The theory of the general property tax originally rested on the assumption that fiscal equality could be reached by taxing all individuals on their visible property. When the mass of property split up, and the myriad forms of modern intangible personalty disclosed themselves, the basis of the theory was undermined by the new conditions, and instead of equal and universal taxation there was now developed a system of partial and unequal taxation.

If we keep in mind these five different kinds of complication, we shall be able to comprehend how it was that slowly but surely property came to be regarded as a less and less satisfactory form of taxation, and we shall not be surprised

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to learn that it was gradually replaced by other tests of ability to pay.

Expenditure and Product as Tests of Faculty

The next step in the development was the selection of expenditure as the criterion of faculty. Expenditure was first advanced as the best test of ability to pay toward the close of the Middle Ages. The great tax reformers of the sixteenth and seventeenth centuries, like Bodin, Hobbes and Petty, were influenced chiefly by the last argument. The general property tax had everywhere become a mere travesty of justice, and the system was honeycombed by abuses which seemed to be entirely ineradicable. To attain a system of taxation which no one could escape became the watchword of the tax reformers. Since every man, rich or poor, necessarily incurs expenditures, a system of taxes on expenditure was now advocated. This took the form of both direct and indirect taxes on consumption, as well as of taxes on trade and business which were supposed ultimately to reach the consumer. Indirect taxes on trade and commerce had indeed arisen, at a comparatively early period, as a development out of the mediæval system of fees and tolls. But now, in the sixteenth, seventeenth and eighteenth centuries, every European country witnessed the growth of a system of excises or expenditure taxes, which grew in importance as the old general property tax dwindled. The general excise or the single excise became the ideal of the publicists, and was in a fair way of being realized in practice.

While, however, consumption taxes succeeded in avoiding some of the worst abuses of the general tax, it was not long before this system in turn disclosed difficulties in its operation. If the rich man stood from under in the general property tax, it was largely because the rich man's property could not be reached. With the development of expenditure as the test of faculty, however, it was inevitable that the rich man should again escape his share, because of the disparity between expenditure and revenue in the different social classes. The lower we go in the economic scale, the greater is the lack of equilibrium between revenue and expenditure. At the bottom of the scale are those whose incomes only barely suffice for their living, while at the top of the scale are those whose expenditures, no matter how large, are but a fraction of their revenue. In

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the one case there is absolutely no surplus available; in the other the surplus is many times greater than the expenditure. Necessarily, under such a system, a tax on expenditure becomes an increasingly heavy burden on the least wealthy classes. It is for this reason that we can explain the comparatively slight resistance to the adoption of the excise system throughout Europe at a time when political life was still controlled by the aristocracy of land or of moneyed capital. But it is evident that with the growth of democracy in more recent times a system of taxation which inevitably results in undue burdens on the less fortunate members of society was destined to become unpopular and to pass away. Expenditure becomes an unsatisfactory test of ability to pay, not only because it puts a premium on the penurious rich man, but because it imposes a crushing burden upon the average poor man. One of the first efforts of the French Revolution was to abolish not only the remains of the *taille,* or general property tax, but also the whole existing system of taxes on consumption; and the history of the nineteenth century in every progressive country has been the history of the attempt to reduce the burden of the excise taxes so far as they are still liable to the objections mentioned above. As a consequence, expenditure has been virtually abandoned as the sole test of faculty.

The next stage in the development is represented by the adoption of product or produce as the norm of taxation. We have learned of the shortcomings of property as the test of justice, and we have seen that the adoption of expenditure in lieu of property was supposed to meet the objections of lack of universality. With the failure of this system, however, tax reformers and progressive governments reverted to some of the other defects of the property tax, such as the discrepancy between the value and the yield of the property, and the inequality of the tax due to the escape of the property owner. It was reasoned—and with considerable force—that if recourse were taken to the produce of the property rather than to the property itself, several results would be achieved. In the first place, a man would be taxed only upon what he actually received, and the hardships of payment without revenue would, at once, be avoided; while secondly, and still more important, the tax, instead of being assessed on the whole of the property, and thus being subject to the abuses either of inquisitorial

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assessment or of illegitimate evasion, would be levied directly on the produce of the thing itself, which yielded a return. Property would be split up into its constituent elements, and the tax would be levied on the yield of each. Thus the tax would be levied on the produce of a piece of land, irrespective of who owned the land; the yield of the land was to be ascertained by a careful process, and if the taxes were not paid by some one, the land would be sold. In the same way as the rental of a dwelling was easily ascertainable, the house tax was now imposed upon the dwellings when they were actually rented, and only then, and if the tax were not paid by some one, the house was sold. So a business was conceived of as an entity, the product of which was to be measured by outward signs, such as the location of the business, the number of the clerks, etc., and the tax was imposed upon the business itself. A similar method was pursued with the other forms of property.

Thus there developed during the seventeenth, the eighteenth and the first half of the nineteenth century, a system of taxes on things rather than on persons, or a system of taxes on the product of the property rather than on the person of the property owner. This is the system which became known in France under the name of real taxes (*taxes réelles*) as opposed to the old personal taxes (*taxes personnelles*), and which was termed in Germany *Extragssteuern* as opposed to the old *Vermögenssteuern*. In France it was the work of the Revolution which created a system of real taxes; in Germany and the other continental countries the movement had begun earlier and was completed somewhat later. In England, also, the same system developed, being composed, at the end of the eighteenth century, of the land tax—the last survivor of the mediæval general property tax,—the house tax, and the assessed taxes.

The adoption of product or produce as a test of faculty indeed marked a decided step forward. But, as time went on, and especially after the industrial revolution, the shortcomings in the theory disclosed themselves. The very excellence of the idea of regarding only the thing rather than the person now itself gradually became a weakness. For, after all, taxes are paid by human beings and not by inanimate things. A piece of property may be assessed to taxation, but the tax must be paid out of the pocketbook or bank account—that is out of the

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revenue—of some person. Since, under the system of private ownership, every piece of property belongs ultimately to an individual, to tax the yield of a piece of property really means finally to tax the revenue of an individual. As soon, however, as we regard the relative condition of individuals, it becomes apparent that a system of taxes on product is painfully defective. Two adjoining pieces of property, for instance, may enjoy precisely the same yield; yet in the one case the yield may be due exclusively to the bounty of nature, and in the other case it may be the result, in large part, of the supplementary efforts of the owner. Allowance may indeed be made for this state of affairs by distinguishing the net from the gross produce, and by levying the tax on the former. Primitive land taxes, for instance, like the tithes of old, were taxes on gross produce; whereas the more approved modern form of product taxation is a tax on net produce; that is, making allowance for the expenses of cultivation. But this, although an undeniable step in advance, is not sufficient; for a system even of net produce taxes does not take account of the indebtedness of the individual. The net produce of two farmers, after allowing for the expenses of cultivation, may be precisely the same; but if the owner of one farm has purchased it on a mortgage, his final net earnings will be less than that of his neighbor. The net produce of a piece of property, in other words, is no necessary indication of the net revenue of the owner. The tax upon the thing, just because it is upon the thing, does not lend itself readily to the shifting conditions of the man who owns the thing; and yet the real ability of a person to pay taxes must be in some relation to his individual condition. Moreover, the immense increase in modern wealth and the appearance of prodigious fortunes have contributed to bring into prominence the idea of graduated taxation. Manifestly, however, a system of real taxes or taxes on product does not lend itself to the progressive principle. The larger piece of land may be owned by the poorer man, and the great wealth of the rich man may consist of a number of relatively small separate pieces of property. A system of taxation which in its very nature does not admit of progression evidently could not permanently respond to the necessities of the situation. With the revolution in the conception of faculty, the tax on product or on things thus came to be continually more unsatisfactory. Just as the gross produce

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system gave way to the net produce system, so now the net produce system in its turn was bound to disappear.

Income as the Test of Faculty

It was thus that the fifth and final stage was reached, and that income was selected as the test of faculty in taxation. And there is no doubt that, taking it by and large, this responds more accurately to modern demands than any of the preceding tests. Accordingly, for a time, it seemed as if the new test would supplant all the other criteria, and as if all direct taxes at least would be abolished, to be replaced by a single income tax. Here again, however, more careful study disclosed certain weaknesses and disadvantages in income as the sole test of ability to pay. What are these weaknesses?

In the first place there is the difficulty of deciding with accuracy what income really means. Do we mean by income gross or net income; and, if the latter, do we include in the term everything that comes in within a definite period, or should gifts, inheritances, and speculative revenues be excluded? Furthermore, do we mean by income only money income, or also the equivalent of money income? These points will be discussed below. Even assuming, however, that a satisfactory conclusion has been reached on this matter, the next difficulty arises from the fact that all incomes do not afford equally good criteria of a man's ability to pay. Is an income of $1,000 derived from hard personal work to be put exactly on a par with an income of $1,000 derived from an inheritance, or from a lucky turn in the market? The further question arises as to whether different amounts of income present identically the same criteria of ability to pay. Is $1,000 which forms the entire income of a day laborer to be treated in the same way as the $50,000 income of a millionaire? Manifestly, the identical rate on all kinds and amounts of income does not constitute an ideal criterion of tax-paying ability. But still further, even if we assume that these difficulties are in some way disposed of, let us compare the two following cases: A is a bachelor, in good health, with no independent relatives, residing in a small town where the scale of life is simple, and so little interested in charity or public affairs that he lays by a considerable amount every year. B is the recipient of precisely the same amount of income, but is a married man, with a large family; he lives in a great city

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with its multitudinous social demands; he is in poor health and must spend considerable sums on physicians and medicines; he has relatives dependent upon him; and he is such a model citizen that he gives largely to charities and to public purposes. Can it be said that these two men, with precisely the same income, have precisely the same ability to pay? Finally, let us take the case of two men, one of whom has invested a large sum in business or in securities which yield a definite annual revenue, while the other has invested the same amount for speculative purposes in a piece of real estate which remains unimproved and therefore unrented, or in a railway stock which happens that year to pay no dividends. Can it be said that the latter has no ability to pay at all, as compared with the former, because he receives no income?

These are but a few of the perplexing problems that confront us as soon as we make the claim that income is a perfectly satisfactory or ideal test of faculty As a matter of fact, while income is in many respects a better test than any of the preceding criteria that have been mentioned, it is not a thoroughly adequate test, for the simple reason that no single test of ability can be found which will adjust itself to the varying needs of individuals.

It is for this reason that the early enthusiasm for the single income tax, even in theory, gradually died away, and it was realized, to an ever increasing extent, that income must be supplemented by the other tests of faculty in order to form a well-rounded whole. No modern tax system, accordingly, relies entirely upon an income tax, even as the sole direct tax. Each of the preceding tests, while unsatisfactory in itself, nevertheless possesses some advantages which can be utilized in framing a system of taxation; property, product, expenditure, nay, even polls—each in turn can be employed as a partial test of faculty in order to fill out certain gaps. For instance, property may be utilized as a partial test in the case of wealth held for enjoyment, rather than for gain; in the case of property invested for speculative purposes; in the case of property where, notwithstanding the temporary cessation of product, the money value is by no means negligible; in the case of a desire to tax property incomes at a higher rate than labor incomes; and, finally, in the case of great fiscal exigencies where it is necessary to take a part of the property itself, rather than simply its income.

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A tax on product may be essential where a personal tax on the individual would be impracticable. A tax on expenditure is sometimes desirable either where the income cannot be ascertained or where, because of the temporary character of the individual's sojourn, a property or income tax could not well be enforced. To assert, therefore, as is often done by superficial thinkers, that the income tax is the fairest of all taxes, is to maintain an untenable position. Purely as a matter of theory, even, an income tax is by no means always the fairest of all taxes. The most that can be said with accuracy is that, in the main, so far as direct taxes are concerned, the system of taxation ought to be so framed as to correspond roughly with the income of the various classes of taxpayers. But to say that the ideal can be reached by any single income tax is preposterous. While the system of taxation should endeavor, roughly at all events, to adjust itself to income in general, the income tax as such can form only a part, even though it may be a permanent part, of the system, the other elements of which must be based upon the remaining criteria of faculty in order to reach as close an approximation to justice as may be possible.

Finally, we are confronted by the question of the practical working of the income tax. Even if the income tax were the fairest of all taxes,—which, as we have seen, is not necessarily true,—the decision as to whether it ought to be utilized would depend largely upon whether this fairness, which is predicated of it in the abstract, would ensue in actual practice. It is notorious, however, that of all taxes the income tax is perhaps the most difficult to assess with scrupulous justice and accuracy; so that what is conceived in justice often results in crass injustice. If, therefore, we add these great practical defects to what are undeniable theoretical shortcomings, we are forced to the conclusion that the income tax is by no means the panacea which it has often been represented to be.

With all these reservations, however, there is no doubt that in the struggle for social and fiscal justice the income tax is assuming a continually more prominent part, and if we do not pitch our expectations too high, we can understand why this should be so. Under certain conditions the efficiency of the income-tax administration may gradually be improved, and under most conditions the addition to the tax system of the

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right kind of an income tax constitutes an undoubted step in advance. To ascertain what these conditions are, and what constitutes the right kind of an income tax, is therefore a study eminently necessary.

BRIEF EXCERPTS

It can be proven that the average American citizen works one month out of the year for the sake of being governed. In other words, taxation takes one-twelfth of his earnings. *Robert Luce. Public Opinion. 13:51 April 23, 1892.*

The characteristic of the best tax is not that it is most nearly proportioned to the means of individuals, but that it is easily assessed and collected, and is at the same time most conducive to the public interests. *Hugh McCulloch. Taxation and Funding. p. 18.*

No sound tax policy can be formulated that does not take into due account all of the principles above announced. But the basic principle that taxation should be imposed as nearly as possible in proportion to relative ability to pay, commands the unanimous approval of the Committee, and in that position it is believed to be in accord with the best modern opinion of political economists and authorities upon taxation in all countries. *Report of the Joint Special Committee on Revenue and Taxation. South Carolina. 1921. p. 52.*

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PART II

THE SALES TAX

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BRIEF

RESOLVED: *That it would be better for the United States to adopt a general sales tax in place of the higher surtaxes on income and the excess profits tax.*

AFFIRMATIVE

INTRODUCTION:

A. Surtaxes on income and excess profits taxes defined and explained.

B. General sales tax explained.

C. Importance of the question.

I. The higher surtaxes on incomes and the excess profits tax have failed completely.

  A. They are wrong in principle.

    1. They tax some people at higher rates than others.

    2. The rates of the surtaxes are too high—the highest in the world in 1920.

    3. They collect the bulk of the revenue on income, which is a very poor basis for a system of taxation because it is variable and intangible.

  B. They have not been successful as taxes.

    1. They are difficult and costly to collect.

    2. They are extremely inquisitorial.

    3. They do not yield sufficient revenue.

      a. The yield falls off very greatly in a year of depression.

    4. They are evaded more and more.

      a. By issuing stock dividends.

      b. By buying tax exempt securities.

      c. By selling stock and liberty bonds, so as to show a loss, and then buying them back again.

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C. They have produced many harmful results.
1. They drive large incomes into tax exempt securities.
a. This prevents accumulations of savings available for investment.
2. They encourage extravagance in business.
a. Foresight and careful management are no longer rewarded.
3. They encourage overcapitalization.
4. They increase prices unduly.

II. A general sales or turnover tax would remedy these evils.
A. It is sound in theory.
1. It falls upon all alike—those who consume the most would pay the most in taxes.
2. It is easy and cheap to collect: the tax would be added to the selling price without elaborate and expensive government machinery.
3. It would be constant in yield.
4. It is a broad and sure basis for taxation: a slight change in the rate would greatly increase the yield.
B. It would not disturb general business conditions.
1. It would encourage thrift and investments, and tax only extravagance.
2. A very low rate on all sales would yield a large government income.
a. Prices would not be greatly raised.

III. The sales tax is a practicable remedy.
A. It has been used with great success in France, Canada, Germany, Mexico, and the Philippine Islands.
B. It is endorsed and recommended by many of our ablest financiers and businessmen.
1. Otto H. Kahn.
2. Jules S. Bache.
3. Charles H. Lord.
4. Myer D. Rothschild.
5. Senator Reed Smoot

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NEGATIVE

INTRODUCTION:

A. The plan and working of the surtaxes on income and excess profits taxes explained.

B. The plan of the sales tax explained.

C. The support of the sales tax is chiefly the propaganda of a few New York bankers.

D. There is much loose talk about taxing extravagance, or taxing sales, or taxing tobacco, but a government can tax only its people and it should tax them in proportion to their ability to pay.

I. The surtaxes on income and the excess profits tax have worked remarkably well under the circumstances.

  A. They were well and carefully planned.

    1. The government had the advice and help of the ablest tax experts in framing them.

    2. All allowances have been made not to hinder business or work any hardships.

  B. They have been successful as taxes.

    1. They are easy and cheap to collect.

    2. They are very difficult to evade.

    3. It is impossible to shift them to others.

    4. They yield the funds the government needs.

    5. Their yield has been all that was expected.

  C. They are equitable, just, and fair.

    1. They fall upon people in proportion to their ability to pay.

    2. They supplement the tariff taxes, the internal revenue and excise taxes, and the other federal taxes which unjustly and unfairly put the burden of taxation on the poor.

    3. For the first time in American history our scheme of federal taxation has been fair and just to the poor people.

      a. This is better for the country because the rich will now be more interested in good government.

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D. They do not interfere with legitimate business.

1. Somebody must bear the burden of war taxation for generations to come, and all should bear it in proportion to their ability to pay.

2. A legitimate margin of profit is left to honest business enterprises.

II. A sales tax is very undesirable.

A. A sales tax in place of the surtaxes and excess profits tax would put the whole burden of war taxation upon the poor.

1. It would all be shifted to the ultimate consumer.

a. This would greatly increase prices—the tax would pyramid, so that the ultimate consumer would pay much more than ever comes into the treasury of the government.

b. It would be a tax against a living wage.

c. People would be taxed in proportion to their needs, not in proportion to their ability to pay.

2. The rich would practically cease to bear any of the burden of war taxation.

B. It would tend to disorganize business.

1. Business would have to adjust itself to the new conditions.

2. Every change in the rate or the subjects of the tax would necessitate a business readjustment.

3. Periods of contemplated change would bring uncertainty and chaos to the business world.

C. It would strengthen and entrench trusts and monopolies and crush out small competing establishments.

1. It would give a very great and unfair advantage to those industries which combine several processes of manufacture over competing industries that perform only one or two of these processes.

D. It would threaten and endanger American institutions.

1. It would cause discontent and unrest among the poor.

2. It would aid the cause of Socialism and Bolshevism.

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III. The sales tax is impracticable.

A. It would be difficult to collect.

1. Most people in small business enterprises do not keep track of their individual sales.
2. There is no way of knowing when such a person is paying all he has collected from the consumers.
3. It would amount to "farming out" the taxes.

B. It is easy to evade.

1. Much more would be paid by the consumers than would be received by the government.

C. It is doubtful of yield.

1. It would fall off very greatly in a time of industrial depression.

D. There is nothing in the experience of other countries to justify us in this experiment.

1. Most anything "goes" in a partially civilized subject nation like the Philippine Islands.
2. Canada's experience with the sales tax is far from satisfactory.
   a. It only applies to a very small part of the sales, and exempts all of the necessities.
   b. It has been tried but a short time.
3. It has been a disappointment, indeed a failure in France. (Nation 112 : 683)
4. We are not ready to pattern any of our governmental affairs after Mexico.
   a. The report of the Carranza Tax Commmission on a Model Tax. Plan recommended the repeal of the sales tax.

IV. The sales tax is opposed by practically all the recognized authorities on taxation.

1. Prof. Edwin R. A. Seligman of Columbia.
2. Prof. Thomas S. Adams of Yale.
3. Prof. Fairchild of Yale.
4. Prof. Kemmerer of Princeton.
5. Robert H. Montgomery.
6. Joseph W. Fordney.
7. David A. Wells.

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INTRODUCTION

The first and most important of the maxims with regard to taxation that were laid down by Adam Smith almost one hundred fifty years ago, that taxes should be apportioned among people in proportion to their ability to pay, is a rule that has been accepted by almost all the best authorities who have written upon the subject since that time, but it is a rule, so far as our federal government is concerned, that has been "more honored in the breach than the observance." From the adoption of the federal constitution until after the United States entered the great war our national government was supported almost entirely by funds collected by means of the tariff or customs taxes and by the internal revenue or excise taxes together with the earnings of the post office, all of which are consumption taxes, that is, taxes upon people not in proportion to their ability to pay, but in proportion to their needs, in proportion to what they eat, drink, wear, and use. It was only under the stress of war necessity that this policy was changed by the adoption of the excess profits tax and the higher surtaxes on income and the federal goverment began to collect any considerable part of its income from taxes that fell upon the people in proportion to their ability to pay.

We are told in the Eleventh Report of the Michigan Board of State Tax Commissioners and State Board of Assessors (1920. p. 25-26) that the history of taxation and of attempted tax reforms is a record of a continuous struggle between different economic classes of society to shift to another class the burden of taxation. In the earlier days these struggles were often attended with violence and bloodshed, but now they are fought out at the polls, in the committee room, and in the legislative halls where the weapons are chiefly oratory, literature, lobbies, and organized propaganda. In the proposition to repeal the excess profits tax and very greatly to reduce the higher surtaxes on incomes and to adopt in lieu thereof a general sales or turnover tax, we have a concrete example of this struggle between classes. It is the old controversy merely in a different form. Here the issue between classes is squarely joined.

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It is not so one-sided a question as one might be inclined to think at first glance, and a middle ground may be the wisest course. The surtaxes on incomes were higher in the United States in 1920 than anywhere else in the world. Able and public spirited business men declare that the excess profits tax, with the other heavy tax burdens on business, is killing industry. They say that vast sums have been driven into tax exempt securities which otherwise would have gone back into the channels of industry to develop and expand industrial undertakings. This, they claim, is at least a contributing cause of the present industrial depression. Certain it is that the revenue that the federal government has derived from the excess profits tax and from the income tax was considerably smaller in 1921 than it was in 1920. Whatever may have been the injustice and the unfairness of the extensive use of consumption taxes by the federal government during the first century and a quarter of its existence, still the fact remains that in 1920 it collected less than one-quarter of its income by such forms of taxation.

Taxation will be a great national problem for years, possibly for generations to come. It is a problem that deserves far more thought and attention by the people generally than it has received in the past. It was less than forty years ago that Francis A. Walker commented upon the dearth of literature of taxation in the English language. While, most fortunately, this condition is no longer true, still almost any librarian will now say that among the books in his library that are least used are those on taxation. Were this not so we should hardly expect to hear a distinguished champion of the sales tax support his cause with any such obvious sophistry as, "It rests fairly as between citizens. The one who consumes the most and spends the most, pays the most in taxes." So unfamiliar are many people with the facts and the literature of taxation that some may fail to realize how absolutely untrue and ridiculously absurd the above statement is. In a brief, general, and very elementary discussion of taxation written more than twenty-five years ago Dr. Frank S. Hoffman said (The Sphere of the State. p. 120) "Ought what a person consumes to determine the portion that he should contribute to the support of the government? . . . The man with millions and few personal expenses might often by this arrangement contribute less to the support of the government than a day laborer with a large family who possessed almost nothing. . . It can hardly be doubted that our national

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taxes upon salt, coal, clothing, and the materials used in the construction of dwellings, violate the very first principles of justice and economics. . . The expenditure system, or tax on consumption, oppresses the working classes, obliging them to pay not only their own taxes but a large proportion of the taxes of others."

The younger student must not be misled by the oft-repeated phrases of "taxing tobacco" or "taxing sugar." Any government can tax only its citizens. All taxes are paid by people. It may be that the different people pay their taxes in proportion to the amount of sugar and tobacco they consume, but the taxes are paid by people and not by tobacco or sugar. The problems of taxation are only to determine in what proportion, on what basis, and by what method the government shall assess taxes upon its people.

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AFFIRMATIVE DISCUSSION

WHY NOT A SALES TAX [1]

A discussion of the gross sales or turnover tax, which is confined alone to that tax, is futile in helping to reach a conclusion as to its availability.

While it is essential that the advocate of that tax should first refute as far as it is in his power the objections raised by its opponents, he should above all endeavor to show the greater objections to each of the other taxes, and thus, by the process of elimination, endeavor to prove that the turnover tax, while by no means ideal, is the one against which the fewest objections can be raised.

Idealism and taxation are about as great antitheses as one can find. Taxes must be viewed in the light of necessary evils, and, while it may be permitted to drift on ideals, hard, practical, common sense must be used in handling evils.

As I participate in discussion after discussion on the subject of the turnover tax, I find two fundamental criticisms, and practically *only* two.

I have searched in vain through the writings of Professor Adams, of Yale University, the leader in the opposition to this form of taxation, for any other objections on which to center an argument, but they are all so easily refuted that in most of his addresses he refutes them himself.

The two objections which I say are fundamental are, first, the question as to whether the tax can be passed on, otherwise making it a tax on gross income, and, second, the further question as to whether it will result, as Professor Adams claims, in monopolizing the movements of an article in the processes of its manufacture, giving the self-contained business a prejudicial advantage, thus leading to the elimination of the middle man.

[1] By Jules S. Bache. Review of Reviews. 63:57-60. January, 1921.

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Minor Objections

There are many criticisms which I deem hardly of sufficient importance to mention more than casually. Among them are:

1. That if the tax is shifted, as it must be, it would be a tax against the living wage.

I contend that this is far less likely in a general sales tax than in the proposition of specifically taxing sugar, coffee, tea, etc., making the tax identical, on the cheap article, with that upon the dear article, and in the case of the already existing taxes, of the specific levy on about fifty different kinds of business in which the tax is unquestionably against the living wage.

Even if it could be construed that the general sales tax might rest to some extent in greater effect upon the small wage-earner, that can be more than offset by raising the income tax exemption to $5000.

2. That the tax will be loaded.

I think the basis for this assertion is in the fact that the present excess profits taxes are undoubtedly being loaded, and overloaded, as they are passed along, but this is because of the uncertainty of these taxes. There would be no such uncertainty in the sales tax. It is true that the business dealing in a multiplicity of articles and finding it impossible to pass the fractional amount on, which a 1 per cent tax would call for, on any one of the articles, might seek compensation for the loss, in loading the small difference on to some other one of its numerous lines. The infinitesimal fraction which 1 per cent on a cheap thimble might call for, might be added to the fraction on some other similar article, in order that the firm may recover from the ultimate-consumer its complete overhead, as called for by this tax.

3. That the amount which such a tax would produce cannot be calculated.

This I will admit only partially; but it is not a good objection, since one year's application would prove it completely, and even though it is admittedly difficult to calculate what such a tax would produce, there are bases on which to found calculations, viz.:

France has a population of about one-third that of the United States, and a much more thrifty population. In its calculations, upon which the 1 per cent turnover tax was based, the fiscal

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authorities counted upon the tax producing $1,000,000,000. In practise, since July 1, when the tax began to operate (and all taxation experts admit that in its initial stages no tax produces full returns), the collections have been satisfactory, and the French Commission here expects that it will bring returns fully up to the estimate; and on that basis, and without allowing for the increased proportionate expenditures of our population in comparison with those of France, we would raise $3,000,000,000.

Taking the latter element into consideration would give some color to the objections that the yield of the tax would probably be considerably in excess of the amount estimated. I have never found taxing authorities objecting to a tax which yields more than is calculated; but if it should do so in this instance, the rate can promptly be reduced, and the temporary excess used for a decrease of the national debt.

Expert estimates have varied all the way from $3,000,000,000 to $7,000,000,000, but one of the leading members of the Finance Committee of the Senate, who has been in touch with this movement ever since its inception, has stated that he is prepared to go on record with the prediction that this tax will net very close to $4,500,000,000 in its initial application.

4. Administrative difficulties.

Professor Adams, in his recent speech before the Economic Club of New York City, drew particular attention to the fact that the tax bureaus in Washington were on the verge of a breakdown. I consider this one of the strongest arguments in favor of a simple, automatically collectible tax, such as this one, which will, in my opinion, and in the opinion of those who have studied the situation, furnish material relief to the burdens in Washington. But at all events, objection should hardly be raised to a tax which will relieve the mental and manual labor required for the collection of taxes by an administration employing as many as seven hundred thousand functionaries.

The staff now being employed on the excess profits tax and on fifty-five individual and different sales taxes, would be found to be far in excess of that required to collect a simple and automatic turnover tax.

5. That the attempt to institute this tax would lead to opposition from the man in the street.

I believe that this is merely a question of education. The American laboring man, farmer, and business man is essentially

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fair-minded, and, while it is a natural tendency (not peculiar to the inhabitant of the United States) to unload one's burdens on one's neighbor, I believe that the average American is less inclined to do this than the citizen of most nations. But while with little difficulty it can be shown that no one's burdens are in any way lightened by the present system or other mooted systems, the great majority of the business world of this country would have its burdens almost entirely lifted by the initiation of this form of taxation, and enthusiastic approval could be enlisted.

I have had a recent expression from a power in the farming world that it would take very little general information to the farming community of the United States to put them solidly behind this tax. The very agitation for a specific tax of 2c. on coffee and sugar, and 10c. on tea and gasoline, would, I believe, prove educating to the farmer; and when we stop to consider that the political opposition is dwelt upon as an argument against the tax by the very people who recommend these specific taxes on sugar, coffee, tea, and gasoline, it is, to say the least, amusing.

I believe that a tax so equally divided that every man, in proportion to his station in the community, would shoulder his share of it, would become quite popular, if that fact were used as an argument against it.

Fundamental Objections Answered

This brings me back to the discussion of the two fundamental objections already mentioned, viz.: (1) Doubt as to whether it can be passed on; and, (2) Giving an unfair advantage to businesses which combine the processes of manufacture of an article over those which are engaged in only one or two of those processes.

I believe the turnover tax will ultimately be looked upon as an overhead charge, pure and simple. In passing it on it must be treated in the same manner as any other overhead charge, such as rent, labor, and kindred items. In times of falling prices it is possible that none of these charges can be passed on. The tax would share the same fate.

Business must be visualized as being conducted for profit. Times of loss must necessarily be the exceptions, or no business concern would remain solvent; and in times of profit all over-

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head is passed on. Some overhead is passed on in an exaggerated form. This tax never should be. It can be too easily calculated. Rent and labor may be an unknown quantity to the purchaser of the goods, but this tax will be a known quantity. Its amount can be specifically stated at the bottom of a bill. It will be so small when so stated, in proportion to the amount of the bill, that it will hardly cause any irritation. The practice of specifically charging it in a bill would make it a habit, and we are decidedly a people of habit. The first straphanger in a street car was surely a disgruntled individual. Straphanging has become a habit.

If, for any reason, the tax cannot be passed on (and no one has as yet voiced any particular instance where that reason exists) it should not be allowed to apply. I believe that this latter policy should be a basic element in any provision for this tax.

As to the other objection, viz.: That it will lead to monopoly in business by the elimination of the middle man, I consider this entirely specious.

The United States Steel Corporation has never been attacked for the reason that it controlled in their entirety the movements of iron ore from the mine to the delivery of the finished steel into the hands of the consumer, but because it was accused of monopolizing the volume of the output. Such competition as it has had, has hardly been eliminated under proper management, by its controlling the various movements of the product. But should the tax result in business being more self-contained (and public policy requires protection for the middle man), it would be a very simple and elementary change to double the tax on the turnover of such companies as chain stores which manufacture their own articles, and catalogue mail-order houses; and as the average tax levied on articles which pass through several movements before they reach the consumer will not be over 2½ per cent, a doubling of the tax to 2 per cent on such business would more than protect the middle man, if he needed protection, which I venture to doubt.

The tendency of modern business development has been toward reduction of the cost of distribution. If, in the course of that tendency, it has been found that the cost of distribution is reduced by business being more self-contained, viz: by corporations handling the various movements of the article

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themselves, no sympathy for the middle man has prevented this movement.

The cotton mill which does its own purchasing of raw material, the weaving of the yarn, and the dyeing of same, and which in the past had only purchased the yarn and manufactured its product, has not been attacked by anyone for eliminating one or two middle men by its becoming more self-contained. The silk mill which buys its raw silk in Japan, throws and dyes it, and spins its thread, has not been attacked on that ground.

The ultimate tendency will be for all business to become more self-contained. If this tax should hasten the process, it would only prove that the tax is operating in the spirit of the times.

The basis of world unrest lies in the burdens of taxation. Foreign news which we get from the press is full of suggestions being followed by the finance ministers of the various nations for new kinds of taxation.

The income tax, which theorists have claimed was the ideal method of raising large sums, has been worked until it has obtained a strangle-hold upon all initiative and the limits of national solvency.

The capital tax is but another kind of income tax, which in its results means a steady reduction of the return from the income tax. The sales tax would go on uninterruptedly forever, without injuring the capital from which it was drawn, and would hardly fluctuate more than an average of 10 per cent per annum in its yield. It would grow with the growth of the world. It would become less and less of a burden as its results grew.

If all nations were to adopt it it would put them on an equal footing in attracting constructive immigration. A tendency is already evident of nations desiring to attract immigration, announcing as a policy the abandonment of the income tax. Mexico has already made this announcement. So have some South American countries.

People with confidence in the success of their futures will hardly choose as the field of their activities a country levying large percentages on the results of the individual efforts. I believe that in time the income tax in its present form will be abandoned by all nations. Will this country lead the world in

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this, as it has in many other progressive movements, or will it wait and follow when it is compelled to? This is the problem which the business man must help in solving, since I believe that it is only by the growing popular demand for the application of this tax that our legislators will be forced to adopt it.

Advantages Summarized

In conclusion, I would reiterate the nineteen points under which I have already summed up the advantages of this tax. Where is the opponent of this tax who can give us as many advantages for any other form of taxation? And, above all, for any other tax which can be counted upon to raise such a large percentage of the financial requirements of our government?

These points are as follows:

1. It is a complete change from the present system and meets all the objections to prevailing methods.

2. It is simple where the present system is distressingly complicated.

3. It will produce ample revenue, whereas the taxes now imposed, as profits and incomes decline, must fall far below amounts required.

4. Under the sales tax government revenue is based upon something tangible, namely, the expenditures of the people, which go on unceasingly and do not vary in hard times or good times to such an extent as seriously to affect the revenue.

5. It will stop capital from hiding in tax-exempt securities.

6. It allows the country to save funds for future industrial expansion.

7. It will restore competition, enterprise, and individual initiative, now smothered to death by the pursuit of the tax-gatherer.

8. It will encourage business thrift, stopping the waste of high salaries and extravagances, which can then no longer be charged off against taxes.

9. Its collection is simple and automatic for both the government and the taxpayer.

10. It is fair in its distribution. The one who consumes the most and spends the most pays the most in taxes.

11. It will not increase the price of commodities beyond an average of 2½ per cent, whereas now taxes increase prices nearly 25 per cent.

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12. Consequently, it will tend to reduce present prices to a marked degree.

13. It has been in successful operation in the Philippines for years and has proved in every way satisfactory.

14. It has recently been put into operation in France, and is thus far strikingly successful.

15. Some forms of it are in operation in Canada, and it is so satisfactory that leading interests there are urging that it be adopted as a complete substitute for all other taxes.

16. It is based on sound democratic principles and, by reaching out into new sources of revenue, spreads the tax load equitably and in a way most easily borne by all.

17. As it will be passed along to the consumer, millions of people will pay the tax, but nobody will know it or feel it.

18. It enables every taxpayer to know his tax liability.

19. It is surer in its incidence, simpler in its application, more productive in results, more economical in its collection, and less of a burden upon everybody than any other known form of taxation.

WHY A SALES TAX?[1]

There is a great deal of underbrush to be cleared away before the outlines of a sound and sane overturn sales tax can be clearly discerned. The advocates of a sales tax do not, unfortunately, all talk the same language, and the opponents of any uniform overturn tax joyfully jumble all the divergent views advanced into a straw-man of their own conception and then proceed to try to set it on fire. But it won't burn. Part of it is non-inflammable. This non-inflammable material in the straw-man is the suggestion for a tax at each step in the sale of commodities by any one to any one.

By commodities I mean just what the dictionary says—"goods, wares, merchandise, produce of land, and manufactures."

By a tax at each step in the sale of commodities, I do not mean a tax on the gross receipts of everybody engaged in any activity. I mean a tax so levied that the vendor of commodities shall become the collector of a tax measured by the price agreed

[1] By B. S. Orcutt. Administration. 1:659-66. May, 1921.

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upon with the purchaser, and compulsorily passed on to the purchaser by means of a special charge, as a tax, specifically billed as such, on the invoice to the purchaser.

To approach the situation right in the middle, I mean that if John Smith is a manufacturer of overalls, he must buy his cloth, his thread, his buttons, his buckles, his drill, from various people who manufacture these things. He buys one thousand yards of denim from John Doe at 30c. a yard. The bill is $300 plus, at 1 per cent, $3 tax collected from Smith by Doe and turned over to the government by Doe. He buys ten gross of buttons from John Jones for $8. The bill is $8 plus $.08 tax. He buys from John White a gross of buckles for $2. The bill is $2 plus $.02 tax. He buys from John Green ten spools of pocket drill for $15. The bill is $15 plus $.15 tax. He buys from John Brown ten spools of thread for $7. The bill is $7 plus $.07 tax.

The total cost of material for a gross of overalls is then $335.32, of which $332 is the invoiced cost of material and $3.32 is the invoiced tax collected by the vendors of cloth, thread, buttons, buckles and drill, and turned over to the government.

John Smith goes about his business of manufacture in the confidence that he bought this material at the best possible price and that every competitor has paid the same tax rate on material. Smith sells his gross of overalls for $864, or $6 each. He bills the overalls to the retailer at $864 plus $8.64, or a total of $872.64, of which Smith acts as government collector of $8.64.

The tax on Smith has been $3.32, if there was any tax at all. It has been a consumption tax pure and simple, measured by the amount of his purchases, not of his sales. Every competitor has been obliged to pay approximately the same tax, varied slightly by his skill or luck in buying. The tax has gone into the cost of goods, just as has labor, freight and overhead. Smith and his competitors have each been obliged to make their sales price irrespective of their obligations to collect a tax, and what they do collect goes to the government and is not a percentage paid by them on their gross receipts.

Before the materials got to Smith a similar tax was paid on previous processes, and was all included in the $3.32 that Smith paid. When the manufactured product leaves Smith, the retailer pays the tax of $8.64, or $.06 on each garment. When the

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retailer sells to the poor, downtrodden laboring man at $8 a garment, the tax becomes $.08. It doesn't interest me particularly whether the retailer collects the $.08 tax from the eventual consumer or absorbs it himself. My object is to make it a consumption tax all the way down to the retailer, and to consider it nothing but a consumption tax.

The words "consumption tax" sound fearsome to the politician, who still talks glibly about the tariff. The tariff tax is a consumption tax pure and simple when applied to articles not produced in this country. It is, like the excess profits tax, a consumption tax plus, when applied to articles that are produced in this country. All the present miscellaneous sales taxes are consumption taxes. I tried to explain to a correspondent that tariff tax of 10c. a pound on coffee was a consumption tax. He dismissed my illustration with the, to him sufficient, answer that "the tax on coffee is a tariff matter." Then he added: "Whether your importer enters the amount of the tariff on his bill as a separate item or includes it in his gross price, is a matter of absolutely no consequence. He will get all the market will stand for his coffee in either case."

Precisely, that is exactly what I am trying to get at. He would do the same thing were there no tax, and so would his competitor. The element of competition and price is not influenced by the tax. So with a uniform overturn tax, invoiced as such!

There "ain't no such animal" as a tax that nobody pays. A proper consumption tax is a tax that is passed on to the final consumer just exactly as it is levied, not augmented many times like the excess profits tax, and not absorbed by business like the imaginary tax that sends shivers down the spines of unduly alarmed middlemen.

Now all this is different from a retail sales tax like the present tax on jewelry, or luxuries, or ice-cream. It is different from a tax on gross receipts that may be absorbed or pyramided at the option of the dealer. It is different from a tax on services, or on the transfer of capital assets. It does not conflict with the long established special excise taxes on tobacco and spirits, with the stamp taxes on documents, or with the income tax.

A tax on overturn sales of commodities cannot be a direct

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substitute for the excess profits tax. The two taxes are not comparable except in the one feature of being an ultimate cost to the consumer, for of course without profits derived from the consumer, there is no excess profits tax. Abolition of the excess profits tax involves readjustment of surtaxes and of corporate normal tax to bring about equality between stockholders. This is a problem by itself that would be just as much a problem were there no other tax than the income tax.

Conversely, the clash between special consumption taxes and a general consumption tax would still exist were there no income tax and were all revenues derived from consumption taxes.

As a matter of fact, practical considerations make necessary not only an income tax and a consumption tax, but also certain privilege taxes, which again are in the class by themselves. The problem with respect to classes of taxation is to make them balance properly. Hence, we can discuss the principle of the consumption tax without regard to other classes of taxes.

The issue with respect to an overturn sales tax on commodities is an issue between one, general, uniform tax and many special, irregular, unrelated, confusing, and annoying taxes.

There are now special consumption taxes on some one hundred different articles, laid at different rates and collected by various methods. The resulting confusion is endless, the leakage is unknown, and in many cases the revenue derived is negligible and the cost of collection excessive. Some of these taxes are levied on the producer and some on the consumer.

In the latter (the consumer) class, the vendor acts merely as a collector for the government, and equality is therefore assured as between consumers of the particular articles taxed. Examples of this tax are the 10 per cent collected from purchasers of theatre tickets, the 4 per cent collected on perfumes. cosmetics, patent medicines, etc., the 10 per cent collected on certain alleged luxuries, the 10 per cent collected on ice-creams, etc.

In the former (the manufacturer) class, the vendor pays the tax. There is equality between vendors in so far as each must pay a tax, but there is nothing to show whether the tax has been passed on or absorbed, whether it has been augmented or diminished. Examples of this class are the 5 per cent levied on

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sales of automobiles, 10 per cent on sporting goods, 3 per cent on chewing gum, 100 per cent on brass knuckles, 5 per cent on jewelry.

In neither class is there any rhyme, reason, coördination or guiding principle in the selection of the articles taxed or in the rate exacted. Admittedly, the entire scheme was an emergency recourse, and is illogical, unfair, absurd, and administratively chaotic as a permanent basis of taxation. But a little study of the practical application of these taxes brings to light certain principles that might and should be applied to all consumption taxes.

In practice, the dispenser of an ice-cream soda sets a price of say 15c. for the article, and then collects the tax of 2c. from the consumer. All consumers pay that 2c. It does not enter into the overhead or the expense of conducting the business. It is a tax that "runs with the goods." The element of competition between dispensers is eliminated so far as the tax is concerned. One dealer may use a larger glass than his competitor, or he may use a more expensive syrup, or he may charge 13c. instead of 15c. for his concoction, but the tax remains constant at the rate established by law. It is paid without relation to his income. The competition between himself and his neighbor remains just as it would be were there no tax. It is questionable how much of this tax gets to the government. The Treasury Department doesn't know. But the consumer never fails to pay.

In practice the automobile manufacturer makes a price for his car f.o.b. at the factory. To that price he adds 5 per cent as the tax which he then actually collects from the purchaser, although in this case the law levies the tax on himself. He adopts this procedure because it brings about simplicity and equality in the computation and collection of the tax, just as if the tax had been levied on the purchaser, as was the case with the ice-cream soda. He adjusts his price in competition with his rivals. The existence of the tax makes no difference to him as compared with his competitors who adopt the same practice.

However, all the manufacturers' taxes do not work thus simply. The manufacturer of basketball shoes is taxed 10 per cent if he calls them basketball shoes, but there is no tax if he calls them "sneakers." The manufacturer of a hunting knife is

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taxed 10 per cent if he calls it a hunting-knife. He is not taxed at all if he calls it a sheath knife. The manufacturer of a billiard table is taxed 10 per cent, but there is no tax on a mantlepiece made alongside out of the same materials. These people cannot easily segregate the tax, and it ordinarily goes into general cost to be passed on or absorbed or guessed at. Then it immediately becomes a percentage on gross income.

The manufacturer of toilet soaps is taxed 3 per cent and the manufacturer of candy 5 per cent, on sales prices. Neither can apportion this to individual sales so it goes into cost and becomes a percentage on gross income.

It is right here that the objection most seriously urged against an overturn tax comes into play. Unless the sales tax is definitely passed on to the consumer it becomes a tax on gross income and is open to the criticism that it is unequal as applied to net income. It should always be passed on to the consumer. Hence all the arguments based on the idea of relation to net income are waste motion so far as the dealer is concerned.

An overturn sales tax should be distinctly confined to commodities—that is, to goods, wares, and merchandise—and it should be frankly a consumption tax like the tax on ice-cream, theater tickets, and the so-called selected luxuries. It should always "follow the goods" by specific invoice. It could never then be inflated or have any effect on competition any more than if it never existed.

Assume that all these irrationally unrelated, irregular, pestiferous, specially-selected excise taxes were wiped out, and a general tax, of say 1 per cent were levied on all overturns from the producer to the consumer, with the special and distinct proviso that the tax is an addition to the sale price and is to be so invoiced on the bill. How can such a general tax have any influence on competition or be inflated to consumers or work any injustice as between one producer and another or as between one consumer and another?

The Philippine overturn tax is so administered, the purchaser paying for the stamps which are merely the machinery of collection, not by any means necessary. The French tax, the Canadian tax and the Mexican tax are so administered. All are perfectly simple and satisfactory.

With compulsory invoicing of the tax, all the labored arguments as to percentage charge against net income fall to the

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ground and the carefully worked out tables to prove an imaginary point become a joke.

Nobody has the effrontery at any place or any time to say that there should be no sales taxes. The opponents of a general commodities overturn tax not only admit the necessity of a sales tax in some form, but they urge additions to the present long list of special sales taxes. In the same breath they gasp with horror at the idea of a consumption tax; they nearly strangle over the thought that the consumption tax is not a consumption tax at all but a tax on capital; they see endless confusion in arriving at gross receipts, and extreme simplicity in arriving at net income, although net income can be derived only from gross receipts.

The very first line on the working schedule of every income tax blank—corporate, partnership, individual, fiduciary—calls for a statement of gross sales. The entire return from any mercantile or manufacturing operation is built up on that line. If the result set forth in that line is wrong, the whole complicated structure that follows must be wrong. All that is necessary for the collection of an overturn sales tax is that one line.

There is no suggestion anywhere to abolish the income tax. The income tax cannot be collected without that one line on the return. How a dealer can so confuse his books as to make that line false for the overturn tax and fool-proof for the income tax is entirely beyond my imagination. The somewhat notorious report made by the National Industrial Conference Board Tax Committee declares that under a sales tax "new and complicated problems would arise in the definition of what is a sale." I have always been a dazed admirer of the dialectic sophistries with which that National Industrial Conference Board Tax Committee asphyxiated itself so much to its own satisfaction. I think this particular gem of auto-intoxication is worthy of unstinted admiration. I take off my hat to the accountant who can work out net income from one report of gross sales and can camouflage those same sales for purposes of a sales tax.

It is unfortunate that advocates of a sales tax have allowed themselves at times to display peevishness. This does not blind me—a theorist only—to the equal injustice of the charge that advocates of an overturn tax are those "whose knowledge of taxation is limited and who are concerned solely in selfish

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attempts to pass their burden on to others less able to pay." It does not justify Congressman Frear's accusations that because Otto H. Kahn "wabbled and wavered" over the subject of an overturn tax, his final decision in its favor was influenced by selfish motives.

All of the backbitings are unworthy in a discussion of a big, elemental, vital question that concerns the welfare of every resident of the United States, and therefore of the United States itself. Why not get down to brass tacks?

To get back, therefore, to the same brass tacks, if a druggist can compete with a fellow druggist in the sale of Pluto water at 40c. a bottle while compelling me to pay for a 2c. stamp as a tax, there is no reason why every dealer in every article of commerce cannot be made to collect a tax on his sales in the same manner. The main difference is that where goods are sold in bulk, as must be the case down to the retailer, the sales sheets must show the transaction entire, and the invoice should be made to show the transaction with respect to each purchaser. There is nothing to force the druggist to sell the stamp to me. If he was not afraid I would preach, he might let me have the Pluto water for 40c. and forget the 2c. stamp. In the general process of distribution in bulk this forgetfulness could not be.

Dr. Adams, while admitting the difficulty of administration of special taxes on medicinal articles, fountain drinks, and "luxuries," and even urging their repeal, still insists on the superiority of special taxes on selected articles of general consumption in preference to a general tax on all articles of consumption. Much as I respect Dr. Adams, I must differ from him. It is one of the annoying weaknesses of the present hodgepodge of sales taxes that no force of Treasury employees can ever check up the tax properly. The constantly reiterated assertion of Dr. Adams that a simple, omnibus overturn tax would impose added confusion on top of a present confusion which it is intended to abolish is one of those things no fellow can understand.

Another of Dr. Adams' obsessions is that an overturn tax would favor large multiple process concerns as opposed to a series of single process concerns. As against Dr. Adams' theory I would give far greater weight to the testimony of practical business men. Charles E. Lord, one of the largest cotton

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manufacturers in the United States, ought to know something about his own business. He says:

Multiple process concerns and single process concerns at present exist side by side in the same line of business. Each has its reasons for being. The multiple process concern has certain advantages and disadvantages. It may own sources of raw material, save the profits of intermediary processes, save transportation charges, etc. On the other hand it is clear that in large organizations the overhead and administration charges are greater than in small units, the immobility of the business is greater, often the proportion of the capital not invested in immediately productive sources larger, so that the balance of advantage frequently rests with the single process concern where the product is specialized. The existence of both classes of concerns is due to deep fundamental causes on which so superficial a factor as a 1 per cent tax on sales will have no appreciable bearing.

Mr. Lord finds that in the case of single process concerns whose completed products reach the consumer to say $4.50, the combined tax from that on the raw cotton handled twice (by grower and factor), on the spinning, the dyeing, the weaving, the jobbing and the retailing is 12⅗c., or less than 3 per cent of the consumer's price. In the case of the single process concern the saving in tax would be about 1c., or less than ⅓ of 1 per cent on the final price.

In the case of the wood pulp industry the total competitive difference between a large organization owning its mines and forests, making its own chemicals and carrying on every process up to the finished paper, and single process concerns buying wood pulp and manufacturing paper is only about ⅞ of 1 per cent. Similar figures are reached in other lines of business which have been examined.

Practical considerations like these ought to lay the ghost of monopoly fostered by encouragement of combinations through an overturn tax.

Another bugaboo is the newsboy, the corner fruit man, and the small farmer. How, it is asked, are you going to keep tab on them? You don't have to. It is proposed to differentiate this overturn tax, which is intended to be practical, from impractical taxes like some of those now on the statute books. That can be done by relieving from responsibility, as collectors of the tax, vendors who do not sell more than $500 worth of goods in a month or $6,000 in a year. If the poor newsboy or small tradesman has an overturn of $500 or more in a month, it is high time that some method be found to force him to keep track of his business by keeping at least a cash book. It is safe to say that the resultant benefit to him would be far greater than the cost to him of the tax. As for the poor

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farmer who sells less than $6,000 of produce in a year, it is difficult to feel deep sympathy for the hardship of the tax on him. He not only should, but I venture freely to say that he would, get the same price for his wheat as his neighbor who sold $10,000 worth. The only difference is that he would not have to turn in to the government the 1 per cent collected from the elevator company.

A representative of the Federation of Farm Bureau Associations writes me that the farmer could not collect the tax from the elevator company because the price of wheat is made in Liverpool, that he could not add a sales tax to export commodities and neither could he add it on a falling market. As a matter of fact probably no farmer even sells his wheat directly for export. If he did he would possibly be relieved from collecting that tax from his customer, in which case he would have exactly the same net returns as though he sold it to an elevator company and collected a 1 per cent tax. If Mr. Ford sells a Michigan mule to me for $650 and I sell it in Canada, Mr. Ford bills the 5 per cent tax to me regardless of the destination of the mule. So also if he reduces the price from $650 to $510 he continues to bill and collect the 5 per cent.

What can be done with one article on one sale can be done with many articles on many sales. What can be done with an excise tax on ice-cream soda sold to me, or with a tariff tax on coffee, can be done with any article sold by anybody to anybody, only it can be done much more simply and efficiently and justly.

The same farmer authority—one of Congressman Frear's fifteen ablest men who have ever studied the tax question—assures me that when a farmer sells his goods for less than cost he impairs his capital. Quite obvious. But if wheat at $2 a bushel results in impairment of capital without any sales tax, wheat at $2.02 a bushel with a compulsorily collected sales tax, results in no greater impairment. The tax comes from the purchaser, not the seller. The competition to sell and the loss of capital on an undercost sale are exactly the same with or without the tax.

Are not the words "sales tax" a convenient misnomer? In effect, with a compulsory invoicing, the tax is really a purchase tax. To the extent that the middleman adjusts his price with relation to cost, just as he would do were there no tax, he makes or loses money, but the tax has no more to do with his

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decision to sell at a loss than the labor or freight or rental charge. In fact it has far less to do with it because it is smaller, and it is measured as a cost, entirely by his purchases, and not by his sales.

Another screen of underbrush has been cultivated by advocates of a sales tax who talk about it as a substitute for the excess profits tax. It is nothing of the kind. It cannot be, in the very nature of things. In so far as an overturn tax, by an equitable and systematic distribution of the consumption tax burden, could without injustice produce more net revenue than is produced by the present chaotic sales taxes which it is designed to replace, it would relieve the income tax situation.

The excess profits tax is really nothing more nor less than a surtax on corporations, balancing roughly the surtax on individuals. Both the excess profits tax and the individual surtaxes are higher than their productivity point. General consensus now appears to be that 32 per cent or 33 per cent is about the maximum productivity point of individual surtaxes.

The problem with respect to corporation taxes is to find the corresponding point and method. It is an entirely different story. It has nothing to do with an overturn sales tax, except as rates of income tax may be adjusted to the productivity of the sales tax.

The real question with respect to the overturn tax is whether or not it would be more simple, more just, more easily administered, more productive, than the present chaotic sales taxes, with prospect of additional chaos and added injustice following an addition to the list of arbitrary levies. To that I can see only one answer—Yes.

I have directed my remark chiefly to administrative objections. I have assumed that this gathering would agree to the broad proposition that if it were—as I am sure it is—possible to administer an overturn sales tax and make it just what it ought to be—a consumption tax—there would be no objection to the general principle.

The general principle itself is also simple:

It would provide a base for a large portion of the government revenue more tangible than profits and income; not a base necessarily larger than the present base of special sales taxes, augmented by still more special taxes, but a base firmly determined in equity to all.

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It would rest fairly as between citizens. The one who consumes the most and spends the most would pay the most in this particular tax.

It would not be a special tax on the man who must buy medicine for his children or on the stenographer who buys an ice-cream soda for her luncheon.

Why should a baby pay a specific tax on its medicine for colic?

Why should a man pay a specific tax on a bottle of liniment for a sore toe?

Should a person when he is ill pay a specific tax and not pay a general tax when he is well?

The existing excises tax the motor truck, but not the horse-drawn vehicle doing the same work; they tax the fur coat of the farmer and lumberman which he can scarcely do without, but not a cloth coat which for many uses is less desirable; and they tax the piano necessary for the child to obtain its proper musical education, or the band instrument with which he may later earn his living, but not the toy with which he amuses himself.

It would encourage thrift instead of waste. If you don't buy a silk shirt, you do not pay the tax. If you do buy a yacht, you do pay the tax.

It could not increase the price of commodities beyond the amount of the tax itself.

It would be simple in collection and auditing for both government and taxpayer—or more properly, in the latter case, the drafted tax collector.

It would bring the collection of a substantial part of the revenue up to date.

It would be sure in its incidence, simple in its application, economical in its collection, and would have all the attributes of just taxation.

When this base has been supplied, you can adjust your individual and corporate income tax rates to fit the situation and maintain the proper balance.

SALES TAX EXPERIENCE[1]

The critics and opponents of the sales tax would win a better hearing if they offered any preferable alternative and if

[1] Editorial. New York Times. May 14, 1921.

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they did not claim too much in their favor from the experience of other countries. It approaches false witness to say that the sales tax is disliked or is unsuccessful in the Philippines. All taxes are disliked everywhere, and it is impossible to imagine a perfect substitute; but in the Philippines the sales tax is liked better, or rather is disliked less, the longer it is collected. France is not collecting what was expected from its sales tax, but it is retained in the budget, and it is not criticised there on the points which its opponents make much of here. The fault may lie equally with an optimistic estimate of the yield of an untried and novel tax, or with depression of trade for reasons effective everywhere, and not particularly where there is a sales tax. Too many French taxes are disappointing under present conditions to condemn any one tax in particular because of its specific defects. The introduction of the Canadian budget is particularly embarrassing to those who have emphasized the Dominion sales tax experience as a warning against our following the example.

Canadian budgeteers think so highly of the sales tax that they increased it in their budget this week. The Canadian sales tax is not a general turnover tax, but is confined to traders—manufacturers, wholesalers, jobbers, importers, and not including retailers. This intertraders' tax of 1 per cent is increased to 1½ per cent. The 2 per cent tax on sales by manufacturers to retailers, or directly to consumers, is also increased by half to 3 per cent. Exemptions are foodstuffs in natural state and first sales of products of farms, fisheries, mines and forests. As Canada produces many articles which also are imported, the customs is made 1 per cent above the sales tax. In presenting the budget Sir Henry Drayton did not even refer to objections to the sales tax and was rather apologetic that he did not accept many suggestions by Boards of Trade and commercial bodies to make the sales tax of broader application. The budget speech does not itemize the sales tax proceeds, but the Dominion press mentions $100,000,000. A good epitome of Canadian opinion was given by a Canadian, J. F. M. Stewart, at the recent meeting of the United States Chamber of Commerce in Atlantic City: "The sales tax was well received by the people of Canada. It has not proved burdensome, nor an undue handicap on our commercial activities. It is simple in its application, easy and cheap to collect, and it is productive of substantial revenues."

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Senator Smoot's sales tax bill is so much more inclusive than the Canadian bill, and our volume of trade is so much greater, that his estimate of a yield of $1,250,000,000 is reasonable, even moderate. The exemptions in our proposed sales tax include all businesses of less than $6,000 a year. Below that the tax would be small and disproportionately difficult of collection. Above that better accounts would be kept. Of course, everybody would prefer that there should be no sales tax, or that there should be a better tax. Who suggests one, or doubts that there must be a tax to support the nation's expenditures? What tax could be expected to enjoy a more general endorsement by business men than the sales tax has received? And when the interested opposition is separated from the rest, how small and theoretical is the remnant!

PROPOSED SALES TAX [1]

I desire to take a few moments of the Senate's time this morning for the purpose of explaining briefly the provisions of the sales tax bill which I have introduced, known as Senate bill 202, which I hope may become a part of the revenue laws of our country. For the Record and as a part of my speech I send to the desk a copy of the bill and ask that it be printed in the Record without reading.

Be it enacted, etc., That this act may be cited as "The sales tax act, 1921."

TITLE I.—GENERAL PROVISIONS.

DEFINITIONS.

SEC. 2. That when used in this act—

The term "person" includes individuals, partnerships, corporations, and associations;

The term "secretary" means the Secretary of the Treasury;

The term "commissioner" means the Commissioner of Internal Revenue; and

The term "collector" means collector of internal revenue.

TITLE II.—SALES TAX.

SEC. 201. That in addition to all other taxes, there shall be levied, assessed, collected, and paid upon all goods, wares, or merchandise sold or leased on or after July 1, 1921, a tax equivalent to 1 per cent of the price for which so sold or leased; such tax to be paid by the vendor or lessor.

SEC. 202. (a) That this title shall not apply to sales and leases made during any year in which the total price for which the taxable sales and leases are made does not exceed $6,000.

[1] Speech of Senator Reed Smoot. Congressional Record, April 27, 1921.

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(b) In computing the tax due under this title every taxpayer shall be entitled to an annual exemption of $6,000.

(c) In any case where the full amount of the exemption is not claimed in computing the tax due for the first quarter, the part not so claimed shall be deducted in computing the tax due for the second quarter or succeeding quarters. For the purpose of this act the first quarter shall be the months of July, August, and September; the second quarter, the months of October, November, and December; the third quarter, the months of January, February, and March; and the fourth quarter, the months of April, May, and June.

(d) The taxes imposed by this title shall not apply to sales or leases made by (1) the United States; (2) any foreign Government; (3) any State or Territory, or political subdivision thereof, or the District of Columbia; (4) any mutual ditch or irrigation company; (5) any hospital; or (6) Army and Navy commissaries and canteens; or (7) any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(e) The taxes imposed by this title shall not apply to sales or leases of articles taxable under Title VI or VII or paragraphs (1), (2), (3), (12), and (20) of section 900 of the revenue act of 1918.

(f) Under such rules and regulations as the commissioner, with the approval of the secretary, may prescribe the taxes imposed by this title shall not apply in respect to articles sold or leased for export and in due course so exported.

SEC. 203. That in computing the taxes imposed by this title no credit shall be allowed for any tax reimbursed or paid in any manner to any person in connection with any previous transaction in respect to which a tax is imposed by law.

SEC. 204. That every person liable for any tax imposed by section 201 shall make quarterly returns under oath in duplicate and pay the tax imposed by such section to the collector for the district in which is located the principal place of business. Such returns shall contain such information and be made at such times and in such manner as the commissioner, with the approval of the Secretary, may by regulation prescribe.

The tax shall, without assessment by the commissioner or notice from the collector, be due and payable to the collector at the time so fixed for filing the return. If the tax is not paid when due, there shall be added as part of the tax a penalty of 5 per cent, together with interest at the rate of 1 per cent for each full month from the time when the tax became due.

SEC. 205. That in the case of an overpayment of any tax imposed by this act, the persons making such overpayment may take credit therefore against taxes due upon any quarterly return.

SEC. 206. That the commissioner with the approval of the secretary, is authorized to make all needful rules and regulations for the enforcement of the provisions of this act.

The commissioner with such approval may by regulation provide that any return required by this act to be made under oath may, if the amount of the tax covered thereby is not in excess of $10, be signed or acknowledged before two witnesses instead of under oath.

SEC. 207. That on and after July 1, 1921, sections 628, 629, 630, 902, 904, 905, 906, 907, and 900, except paragraphs (1), (2), (3), (12), and (20), are repealed, except that such sections shall remain in force for the assessment and collection of all taxes which have accrued thereunder and for the imposition and collection of all penalties which have accrued and may accrue in relation to any such taxes.

Mr. President, I have given considerable study to the wisdom of enacting into law a general sales tax, and now present three alternative propositions as a basis for such tax which, stated briefly, are as follows:

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1. A rate of ½ of 1 per cent, but not to exceed 1 per cent, on all sales without distinction of integrated or unintegrated concerns.

2. A rate of ¾ of 1 per cent, but not to exceed 1½ per cent, with a credit for taxes previously paid on goods bought for resale.

3. A rate of 1 per cent, but not to exceed 2 per cent, without distinction of integrated or unintegrated concerns, but exempting each dealer on the first $50,000 of annual sales.

For simplicity of administration and collection of the tax, I have concluded to support the first-named plan, and for the purposes of this bill have specified a rate of tax of 1 per cent. If at any time the amount to be raised from such a tax is to be reduced or increased, the only amendment required to the law would be to change the rate of tax.

The bill I have offered follows closely the provisions of the Philippine sales tax, which today is the most satisfactory tax to all classes and the most productive that is imposed in the islands.

I now ask the attention of Senators to a brief explanation of the principal provisions of the bill. Later, when the revision of the revenue laws is before the Senate, I shall take pleasure in discussing it in detail.

1. *What Is a General Sales Tax?*

A tax on the gross value of goods, wares, and merchandise, whether raw material or manufactured or partially manufactured products, whether of domestic or of foreign origin, and such as are generally sold or exchanged and delivered for domestic consumption, whether in barter or on a cash, credit, or installment basis, which tax shall accrue at the time of sale or lease of all such goods, wares, and merchandise, at the rate of 1 per cent of their total value at the time of such change of ownership. This tax also applies to the total amount or amounts received on all leases of goods, wares, and merchandise.

The 1 per cent sales tax is similar to an overhead charge, to be added to the cost of the goods and finally paid by the ultimate consumer, but there is nothing in the bill to prevent the seller of the goods from absorbing the 1 per cent charge, and that no doubt will be done with many establishments where their sales profits are large.

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2. *What Are the Proposed Exemptions?*

All sales and leases are exempt from this tax when made by—

1. The United States or by any State or Territory, or political subdivision thereof, or by the District of Columbia, or by any Army or Navy commissary or canteen.
2. By any foreign government.
3. By any mutual ditch or irrigation company.
4. By any hospital or by any corporation organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

Sales and leases of the following goods, wares, and merchandise shall also be exempt from this tax:

1. Such as are sold or leased for export and in due course are actually exported.
2. Such as are subject to the taxes imposed in Titles VI and VII of the revenue act of 1918; i.e., beverages, cigars, tobacco, and manufactures thereof.
3. Such as are subject to the taxes imposed in paragraphs (1), (2), (3), (12), and (20) of section 900 of the revenue act of 1918; i.e., automobiles, automobile trucks and wagons, motorcycles and tires, parts, and accessories; dirk knives, stilettos, and so forth; yachts, motor boats, and so forth, to be used as pleasure boats.
4. Total sales and leases on goods, wares, and merchandise which in any taxable year do not exceed $6,000.

3. *What Are Its Advantages When Compared With Other Taxes?*

1. Its extreme simplicity of assessment and collection. The employment by the taxpayers of costly tax experts is quite unnecessary as is the burdening of the tax administrative machinery with complicated, expensive, and long-drawn-out audits causing long delays in the collection of taxes. It is not inquisitorial; it does not raise difficult questions about losses, depreciation, and the like; it is more easily allocated among competing jurisdictions than a tax upon net income. No revenue defrauder in the Philippines ever claimed ignorance of the law in palliation of his offense.

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I notice in the morning paper today a dispatch from Buffalo, N. Y., reading as follows:

MADE INSANE BY TAX BLANK—WOMAN FEARED STORE WOULD BE SEIZED FOR ERROR IN REPORT

BUFFALO, N.Y., April 26.

Papers filed in the county clerk's office here today state that Ethel J. Mahan, owner of a grocery store, became so worried over fear that the Government would confiscate her business because of possible errors in her income tax report that she lost her mind.

The woman was committed to the State hospital for the insane by Acting County Judge Ottoway.

At some future time, Mr. President, I want to go into this question more in detail.

2. Each taxpayer pays out of his gross income his sales tax and automatically grades the amount according to his ability to pay; this grading is far more exact, scientific, and equitable than are the artificial steps or brackets imposed by the net income-tax system of existing revenue laws. Under a sales tax the taxpayer pays as he goes along and does not feel the burden, while under the existing revenue law hundreds of thousands of income taxpayers are today, when reduced incomes are the rule, greatly harassed by the payment of taxes which accrued a year ago when incomes and profits were greater than they are today.

3. The tax rate is low and uniform on all goods, wares, and merchandise. The fact that it applies alike to all mercantile transactions makes possible for greater productivity, together with a low tax rate. The absence in the Philippines of discriminatory tax rates leaves all taxpayers satisfied (1) because all pay the same rate, and (2) because goods sufficiently similar to be competitive, even though not identical, are taxed alike. The high discriminatory tax rates imposed under existing revenue laws appeal to the tax payers as extremely unfair and are resented by them. This is the main cause why the tax administration has thrown up its hands, recommending the repeal of some of these consumption taxes, because they say they are easily evaded and too costly to collect.

4. The taxpayer can tell to a cent and with absolute certainty and with a minimum of effort at the close of business each day exactly where he stands as to profits and tax liability. Under the complicated existing excess-profits tax the taxpayer never knows, to a certainty, what amount of profit he has to add to his business to come out whole. Naturally he adds all he thinks necessary, and experience has demonstrated

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that in many cases he has doubled or trebled the amount, all of which inevitably results, as the goods pass along to the ultimate consumer, in a pyramiding of prices. An investigation made by the Department of Justice in connection with the Lever Act tended to show that as a direct result of the unwise and complex provisions of the excess profits law the prices of certain commodities to the ultimate consumer were increased over 23 per cent. A simple, sane, intelligible sales tax at a rate of 1 per cent, even though pyramided several times, would nevertheless be but a fraction of 23 per cent and would certainly result not in an increase but in a substantial reduction of the present high prices of necessities.

4. *What Other Taxes in the United States Does Its Method of Operation and Accumulation Resemble?*

1. Customs duties on imports. Even though the customs duty is not repeated on each turnover of imported goods on their way from the importer all the way through various middlemen, still the effect on the ultimate consumer of the pyramiding of the various profits on the values, both of the costs of the goods and of the customs duties, is usually several times as great as is the accumulation of the sales taxes. The customs duties usually begin with a high specific or ad valorem rate; therefore the final tax content of the cost of the goods to the ultimate consumer is several times as great as a 1 per cent sales tax can never reach, even with half a dozen turnovers. But American consumers during many years have become so accustomed to the high customs duties and to their manner of accumulation that now they seldom remember that they are paying highly compounded duties whenever they buy imported goods.

2. Tobacco products, beverages, etc., paying high excise or luxury tax rates. The same remarks apply in this case as in the matter of the accumulation of customs duties in the preceding paragraph.

3. Personal property taxes for local purposes, imposed periodically by city and state governments, on goods, wares, and merchandise on the shelves and in the warehouses of merchants and manufacturers. The tax rates in these cases are usually about the same rate as is the sales tax rate, though often in some localities much greater. This tax is collected on

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merchants' stock of goods before they are sold. The sales tax would be collected on identically the same goods at the time of their sale and not before. Surely the merchant and manufacturer are better able to pay their taxes when they have made a sale and have the money than they would be on a lot of dead stock.

5. *What Have Its Results Been in the Philippines During the First Sixteen Years of Its Operation?*

1. It has become the most productive item in the insular tax system.

2. It has not hampered any type of business or manufacture in the island; it is precisely during the life of the sales tax law that commerce and industry of all kinds have thrived as never before.

3. The Philippine Government is enthusiastic over the results of the sales tax and so cabled the Secretary of the Treasury in Washington four months ago, stating that their sales tax was the "most equitable, productive, simple, and economical" tax they had; that the original tax rate of ⅓ of 1 per cent had been increased to a full 1 per cent; and that the Philippine Government was then (December, 1920) considering the advisability of again increasing the tax rate, this time from 1 per cent to 2 per cent per turnover.

4. Prominent merchants with offices in Manila and New York City have in printed statements been equally as enthusiastic over the operation of the sales tax law as is the Philippine Government, as quoted in the foregoing paragraph. Industrial and commercial methods and conditions in the Philippines have, during the last twenty-two years, become thoroughly Americanized as scores of reputable witnesses—formerly in the Philippines and now in this country—are willing to testify. All of which should be sufficient to prove an error in judgment on the part of those in this country who have, on scant knowledge of their own, condemned the Philippine sales tax as being in principle rank economic heresy and in operation impracticable.

6. *Where Does Its Final Incidence Normally Rest?*

Normally, the entire taxes paid on each turnover are shifted and rest finally on the ultimate consumer, this because the purpose of all business is profit and the cost of goods includes

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every item of expense such as raw material, labor, freight, rent, traveling expenses, interest, selling expenses, losses, and taxes. All of these items are normally shifted to the ultimate consumer. It can be demonstrated with mathematical accuracy that even with a half a dozen turnovers, and the corresponding 1 per cent taxes, the price of commodities to the ultimate consumer is very rarely increased over 3½ per cent. Compare this with the 23 per cent increase resulting from the operation of the excess-profits tax. The 2½ or 3½ per cent tax content in commodities bought by the ultimate consumer means that a lot of goods which, sales tax paid, cost him $102.50 to $103.50 would, without the tax, cost only $100. But as a matter of fact the sales tax encourages thrift and eliminates the 23 per cent which the operation of the excess-profits tax now loads on many commodities. Therefore the net result of a moderate general sales tax would be a considerable reduction to the ultimate consumer in the value of the $100 worth of goods in the example given above.

Compared with the merchants' and manufacturers' ordinary profits on each turnover of goods, the 1 per cent sales tax is so small that it was found, after many years' experience in the Philippines, that normally in ordinary commercial transactions very little attention was paid to the tax. Under abnormal conditions, where the profits were larger than usual the sales tax was absorbed.

7. *How Does It Affect the Independent Manufacturer as Compared With the Integrated Multiple-Process Concern?*

For an intelligent comprehension of this problem several factors must be considered:

1. As a rule, the integrated concern produces its own raw material at a minimum cost or pays less for its raw-material purchases in bulk than do its small competitors.

2. It is generally thought that the integrated concern because of its production in bulk, more economical machinery, smaller overhead expense per unit and multiple process from raw material to finished product, turns out goods at a lower cost than do its smaller competitors.

Per contra it is well known:

1. That not all independent manufacturers do business on a small scale, and

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2. That independent manufacturers who specialize on certain finished products are able to compete successfully with the bulk production of large integrated concerns manufacturing the same finished products.

3. That the activities of many concerns, such as automobile manufacturers, consist mainly in assembling parts manufactured by several integrated or independent concerns.

For the purpose of this argument, we are to consider how a 1 per cent sales tax on final output affects (1) a large integrated concern with, say, six multiple processes between the raw material and the finished product as distinguished from (2) a half dozen independent concerns, each performing one of the six multiple processes, performed by the integrated concern, and each paying a 1 per cent sales tax on their output of the partially manufactured product.

The natural assumption would be that the six independent concerns among them would pay six times the amount of sales tax that the integrated concern would pay on the same output. But this assumption would be wrong, for the following reasons:

a. Each of the six independent concerns would shift along to the next independent manufacturer in line all of the original costs of raw material plus the various costs at that stage of the partially manufactured product plus his own profit and the compound profits of the manufacturers who had preceded him and add the 1 per cent turnover tax to the bulk sum of all these items. The total of these six profits en route would make the finished product to the ultimate consumer several times the amount for which the first independent manufacturer purchased the raw material. Therefore, instead of 6 per cent—1 per cent on each turnover—the tax content of each dollar the ultimate consumer paid for a finished product would, normally, range between 2½ per cent and 3½ per cent.

b. The integrated, multiple-process concern would add merely the cost of production in each of its processes to the partially manufactured goods entering the next process and add to the total cost its profit, together with 1 per cent of the total sale price of the finished product, which is normally sold in competition with and at approximately the same price as similar finished products are sold by the last one of the six independent manufacturers.

Therefore, the advantage which the large integrated concern

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would have over each of the independent concerns would be from ⅖ to ⅗ of 1 per cent—that is, 2½ per cent or 3⅓ per cent divided by 6. But as independent manufacturers, large and small, have thrived and continue to thrive alongside of large integrated multiple-process concerns the natural assumption is that they will continue to thrive, regardless of a fraction of 1 per cent advantage. Whether this advantage will be used is doubtful. So far the large concerns have shown no disposition to drive their small competitors out of business. No doubt the large manufacturer is more than satisfied to allow his small competitor to set the price.

Logically competition and the sales tax would result in an increase of 1 per cent or 2 per cent or 3 per cent to the ultimate consumer, and the repeal of the excess-profits tax would result in a decrease to the ultimate consumer of several times that amount. As for the small independent manufacturer and the large integrated multiple-process concern, they should continue in the future, as they have in the past, to operate alongside of each other.

The following table shows how a year ago a suit of men's clothing, retailing at $60, would increase in value from the raw material to the finished product.

By the way, if the same suit of clothes were manufactured today, with wool at its present price, there would be a different result from that shown by this table:

		1 per cent tax.
1.	Raw wool in grease, about $6.50	$0.065
2.	Wool dealer scours wool and sells to spinner, $8	.08
3.	Spinner converts into yarn and sells yarn to the manufacturer $10	.10
4.	Manufacturer weaves and finishes into cloth and sells 3⅓ yards at $4	.1333
5.	Trimmings, linings, etc., 50 per cent of cloth	.1891
6.	Tailor makes into suit and sells at $40	.40
7.	Suit is sold at retail for $60	.60
	Total tax price on consumption	$1.5674

If the sales tax bill becomes a part of the revenue laws of our country Congress can repeal not only the items provided for in the bill as presented by me, but can repeal all of the irritating, nagging, discriminatory taxes amounting to hundreds of millions of dollars, and the excess-profits tax, the result of which has worked such havoc with the business concerns of our

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country, which have in many cases been compelled to pay the excess-profits tax on paper profits.

I have received a few letters of complaint against a general turnover tax from concerns doing business on an average of 2 per cent to 3 per cent profit on their turnover sales and claiming that if the 1 per cent sales tax is imposed it would ruin their business. Perhaps in some cases the imposition of the tax, if it had to be paid by the merchant, would seriously cripple their business; but such concerns must understand that the tax imposed is to be paid by the purchaser. It is to be added to the regular price charged for all goods sold. If the merchant desires to absorb the tax there is no objection to his doing so, but the law does not contemplate any such result.

Some day not far distant America will have a general sales tax law; and with new forms of pensions and bonuses that will become a heavy drain upon the Treasury, together with the 2½ per cent sinking fund for retirement of the public debt and nearly $1,000,000,000 of interest to be paid annually upon the Government obligations, the sooner a general sales tax bill is enacted into law the better it will be for America.

Congressman Mondell repeatedly announces that the House of Representatives will demand a lifting of taxes and not a shifting of them. I want both a lifting and a shifting of taxes, and I know the American people want the same. The expression "consumption taxes" scares the politician much more than it does the American taxpayer. Every internal tax imposed is a consumption tax. The demagogic cry of the unloading of the taxes now supposedly placed on the shoulders of the rich onto all the working population of the United States through a sale tax on goods, wares, and merchandise is a theory and not a fact, and theories never have and never will be accepted as payment for taxes that must be collected to maintain the Government. I declare in the most positive terms that it is such people of the United States that are now paying the taxes, and it will continue so no matter in what form the tax is imposed, unless it be a tax taking part or all of the capital or property of certain classes of citizens.

Many of the taxes imposed under the present revenue laws are disguised and heavily inflated consumption taxes, and when finally paid by the consumer result in an ever-rising cost of the

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necessities of life. They have promoted extravagance and inflation, restricted competition, obstructed the development of our natural resources, discriminated between taxpayers, and are next to impossible to administer.

BRIEF FILED WITH THE TAX COMMITTEE OF THE NATIONAL INDUSTRIAL CONFERENCE BOARD[1]

Recognizing that the fundamental causes for existing high prices and high wages are currency and credit inflation and the destruction of property of every character through war, and that social and industrial unrest are a consequence, as those symptoms usually accompany periods of inflation, the remedy lies in a higher interest rate and more discriminating loaning of funds by bankers and an increase in productive effort by the people to promote deflation in the direction in which the inflation has been caused by the factors referred to.

Another, however, and major contributing cause to the present exalted prices and high cost of living is the method of Federal taxation, whether in the form of excess profits tax on corporations or the heavy surtaxes on the income, particularly the earned income, of individuals, both having exactly the same relation to and effect in causing high prices, and the measure of inflation due to such taxes can only be removed by a change in our method of taxation.

To first indict the existing method so that we may determine what to avoid and what to seek:

It bases the bulk of the government revenue on something highly variable and intangible—profits and income.

It is not producing sufficient revenue at present, and is likely to produce less in the future.

See reply to U. S. Steel Corp. showing Federal tax 1918 $274,000,000; Federal tax 1919 $52,000,000; loss of revenue to government $222,000,000; only partly accounted for by difference in rate.

The high surtaxes on individual incomes are driving those of large income into tax exempt securities.

The buying of municipal bonds and like securities on a large scale is diverting capital from necessary productive enterprises into channels where only further waste and extravagance is being created.

The rapidly rising surtaxes on all but the most moderate

[1] By Charles E. Lord, April 16, 1920.

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incomes is preventing the accumulation of savings available for investment in the further expansion of productive enterprises.

It discourages competition. No man is going into a new enterprise unless there is a chance for a profit which more than offsets the risk. He knows today that if there is a high profit the government takes perhaps half of it in taxes, while if the venture is unsuccessful he must bear all of the loss himself.

Those already in business are content to keep on because the features of the tax by discouraging competition and eliminating supplies enables existing concerns to pass the tax along to the consumer.

The utilization of natural resources is penalized, as, for one thing, the cutting of timber.

An individual who bought timber land a few years ago for $100,000—$50,000 on mortgage and $50,000 capital investment—and whose timber if cut might now bring $400,000, cannot cut it without paying a large portion of the profit to the government in taxes, while so long as the timber stands uncut he pays no tax.

It encourages extravagance in business conduct, high salaries, wasteful methods, unnecessary expense, because the money saved by care in these matters would be largely taken away in taxes.

Careful management is no longer able to reap its customary reward.

It favors overcapitalized and extravagantly managed business as against the conservatively capitalized and carefully managed one.

It is costly to collect, expensive alike to the government and the taxpayer, and withdraws from productive employment tens of thousands of clerks and accountants at a cost of millions of dollars.

It rests unfairly as between taxpayers and works injustice and creates a sense of bitterness and wrong.

Consider three men, A, B and C, all receiving the same income in a given year and paying the same amount of taxes. "A" is an inventor, who perhaps after several years of struggling has finally succeeded in interesting capital and selling his invention for $200,000. He pays the government between surtaxes and normal tax nearly one-half the amount received, and has parted with his invention, the thing which brought him so big a return in one year. "B" is a business man who on a capital of $500,000 employed in a business with a rapid turnover has made $200,000 and, as in the instance of the inventor, paid almost half of it in taxes. "C" is a capitalist with $4,000,000 capital invested at 5 per cent, realizing an income of $200,000 without personal effort and paying the same tax as "A" and "B." At the end of the year "A" has parted with his invention; "B" has added slightly to his capital and still must bear the risks of business; while "C," the wealthiest of the three, remains with his capital unimpaired in a position to keep on earning him the same amount of income.

Because of its character and also because it is an undetermined and indefinite tax it unduly increases the price of commodities.

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A manufacturer or merchant has to consider these factors: Federal taxation, depreciation, dividend or profit, and reserve, all of which must be covered in the margin between cost and selling, and so each factor has its influence in fixing prices. At present, doing business on an inflated basis has an element of unusual risk, and larger reserves than usual are required if the merchant is to remain solvent and meet his obligations during the period of deflation. The effort to build up such reserves, however, is met by the factor of taxes, which increase with the profit, so that in order to get an adequate reserve he must be prepared to pay a heavy tax, the addition of which broadens the apparent margin of profit and lifts prices markedly without any net improvement to the merchant except a slightly larger insurance against a very definite risk.

It tends to perpetuate and accentuate the present inflated situation.

It keeps the taxpayer at all times from three to fifteen months in debt to the government.

There exists today a fear among business men of a bad year following a good year with the heavy taxes incurred by the profits of the good year having to be met out of the meagre returns of the succeeding poor year with the additional possibility that such profits of the preceding year may have been subsequently very large swallowed up by losses.

It is un-American in principle in that it seeks to make one citizen pay more, proportionately, than his neighbor, and attempts to tax endeavor for the purpose of rewarding those who do not make endeavor, and so creates special privilege.

Why was such a method of taxation adopted? I should say, partly because under the sudden emergency of war the existence of a moderate income tax provided the machinery for increasing the burden so as to raise a very large revenue. The means was at hand and was used. The emergency, however, is past and we should promptly discard a theory of taxation which is both so uncertain and working so many evil results, and should seek a method which will be surer in its incidence, more equitable in its operation, simpler in its collection and one which will tend to inflate the cost of living and take from the consumer a sum far in excess of what the government receives in taxes.

Can such a way be found? Certainly; as soon as we commenace to tax what people spend instead of what they save, we are on the right road. The physical activities of the world are reflected in buying and selling, which always goes on. Tax the turnover by taxing sales, and you are taxing something more substantial than profits or income. You are at the same time lifting the burden which is stifling competition and progress, and the wasteful flow of capital into tax exempt securities will be stopped and diverted into productive enterprises.

If any object that under such a method a certain character

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of income should still be taxed as such, then let surtaxes rest against that portion of income which is unearned, as interest, and free the part which comes from work or service.

Under a consumption tax, the man of humble circumstances pays little as he buys little, and every citizen should contribute something toward the support of his government, while as the scale of living rises the tax burden becomes greater as more money is spent for things represented by sales which are taxed. There is a rough, elemental justice in that. The proper way to reach evils in corporate management or bad practices is under our present laws or laws directed against those specific things and not through attempted punitive taxation, which falls alike on the just and the unjust.

The success of a sales tax in operation depends largely on whether levied in a simple or complex form.

Among the considered forms are:

A tax of a varying percentage, according to stages of manufacture.

A method needlessly complicated in attempting to make adjustments where none are necessary.

A tax of a higher percentage against the sales of some one class of traders, as all manufacturers or all retailers.

Such a tax lends itself more readily to being added to or loaded into prices because of the operation of percentage figuring of profits.

A tax levied against the sale of certain articles or articles over a certain price.

Open to the objections and annoyances of the present so-called luxury taxes, and a poor producer of revenue.

A tax to be collected by the vendor from the purchaser.

Involving the merchant in a vast amount of labor and accounting and annoying to the consumer.

A stamp tax against sales.

Easy and economical of collection by the government but open to the same objections as any tax collected by the vendor.

A tax upon sales of real estate.

Open to the objection that such a tax may be a confiscation of capital in a certain class of transactions, as a man has a small farm which cost him $10,000 and which he is forced to sell for $9,000. To tax the sale would mean a further depreciation of the owner's already impaired capital.

A tax of a small percentage, as 1 per cent, on all sales of commodities from producer to consumer levied against gross sales as recorded on the dealer's books.

I favor the latter method and would outline a form for the levy roughly as follows:

1. That there be and is hereby levied upon each and every business involving the sale of any commodities or merchandise manufactured, produced or purchased by the vendor for sale, a tax equal to 1 per cent of the gross sales of such business. A

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return of such tax shall be made and the tax paid monthly on the fifth day of each calendar month on the gross sales of the preceding calendar month, or, if in any such calendar month such gross sales shall be less than $1,000 the return shall be made and the tax paid on the fifth day of the first month succeeding the month or months the gross sales of which shall equal or exceed $1,000 on the gross sales of such month or months.

2. The term business shall not apply to any isolated transaction less than $1,000 nor to the occupation of street vending or peddling unless the gross sales therefrom shall exceed $100 per month.

3. The term gross sales means the aggregate prices on sales made during the period, less prices of any prior sales cancelled or of goods returned during such period.

This should have the usual penal clause for failure to make a return and should be accompanied by a repeal of the excess profits tax on corporations, so much of the individual income surtaxes as apply to earned income and a readjustment of the rate of the normal tax as applied to corporations and the rate or exemption of the normal tax as applied to individuals.

As to its productivity, a tax of 1 per cent on the turnover of commodities should produce over $2,000,000,000. This figure agrees with calculation made by the Actuary of the Treasury.

This amount should offset the excess profits tax, which would scarcely cross $1,000,000,000, and the surtaxes on earned incomes. The adoption of the principle is the essential thing. If some reduction in the surtaxes applied to unearned incomes is to be effected, the rate of sales tax can be increased fractionally beyond 1 per cent or by a moderate increase in the normal tax.

The difficulty involved in defining what constitutes earned and unearned income can be met in several ways. One way is to define in the tax bill certain classes of income as taxable without the use of the words "earned" or "unearned." Another way is to make the unearned income define itself by applying the measure of 6 per cent to the capital of the taxpayer to indicate the proportion of unearned income, applying the surtax in the manner suggested in the margin note.

Retain the present surtaxes or adopt new surtaxes and provide that the taxpayer may at his option by declaring the amount of his capital and his income, including the portion which is at present tax exempt be relieved of any surtax liability beyond the amount represented by 6 per cent on the surtax rate of his entire income applied to his capital. Illustration: Given a capital of $500,000 and an income of $100,000, take first the surtax on $100,000, which is $23,510, or equal to 23½ per cent on the income, and 6 per cent of that gives 1.41 per cent. which applied to

the capital of $500,000 amounts to $7,050 as the total surtax. Prove the result by taking 6 per cent of $500,000, which is $30,000, and you will find that $7,050 represents just 23½ per cent of that amount, so that the portion of the $100,000 income which is not earned by effort, or $30,000, bears the full present surtax of 23½ per cent, while the rest of the income, which represents effort, escapes with only the normal tax.

The cumulative effect of a 1 per cent tax on sales all along the line from producer to consumer can hardly reach 3 per cent on the retail price.

In its early stages, as raw material or partly manufactured, the tax represents but a small fraction of 1 per cent of the value of the finished article.

For this same reason, the tax difference between two manufacturers, one who conducts several processes in his own plant and another who buys his raw material partly manufactured is apt to be not greater than ½ of 1 per cent of the value of the finished article, a difference slight in comparison with already existing differences.

Such a tax would lie against the sales of a vendor (easily determined) with no compulsion upon the vendor to collect from someone else. The government's interest lies in the collection of the tax. It has no concern in the fact that one taxpayer may absorb it while another passes it along or in any apparent inequalities between them arising out of the two methods.

A sales tax of this character meets the objections raised against the present method:

It bases a large portion of the government revenue on something more tangible than profits and income.

It will produce sufficient revenue.

It is manifest that once a tax on sales is in operation and producing a given amount that as the needs of the government decrease the rate of the tax may be lowered; while should a sudden need arise for more revenue, as in the instance of a foreign war, a moderate increase in the rate of the tax would produce it.

It will curb the tendency of capital to seek tax exempt securities.

It permits the accumulation of savings for future industrial expansion.

It will tend to restore competitive conditions and opportunity for initiative.

By removing the prospective taxation of profits and restoring the venture to the ordinary elements of risk.

It will promote the utilization of natural resources.

The timber may be cut without penalty, the invention put to work, etc

It will encourage business thrift instead of waste, as high salaries and extravagances can no longer be charged off against taxes.

It removes the tax advantage at present enjoyed by overcapitalized concerns.

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It is simple in its collection and auditing for both government and taxpayer.

It is a very easy matter for any individual or business house to report sales. A very brief form should suffice, giving the gross sales for the month, or period defined, less returns and allowances.

It rests fairly as between citizens. The one who consumes the most and spends the most pays the most in taxes.

It should not increase the price of commodities beyond the amount of the tax itself, and it tends to be absorbed by the purveyor.

It should work to reduce prices markedly.

Several government authorities have admitted that the existing method of taxation has led to a loading of prices to the extent of 25 per cent, a large part of which does not reach the government. The substitution of a definite sales tax for an undetermined tax on profits should reduce the tax load to approximately 3 per cent, all of which goes to the government, and so save the consumer a large sum.

It brings the collection of a major part of the revenue, that from a tax on sales, up to date.

Will in a comparatively short time end the load of back taxes hanging over the community.

It is based on sound, democratic principles, and by reaching out into new sources of revenue spreads the tax load out equitably and in such manner as to be easiest borne by all.

At present the unsuccessful merchant escapes taxation, while business ability is penalized. Under a sales tax, all pay on their sales, and there is a perfect commercial adjustment.

It enables every taxpayer to know what his tax liability is.

It is surer in its incidence, simpler in its application, more productive in its results and more economical in its collection, and has all the attributes of just taxation.

It also by reducing the amount of revenue dependent upon income taxation removes many of the inequalities inseparable from such taxation. The principle of taxing incomes being a feature of British practice, may be adapted to British conditions, where the law of entail is in force and where many of the large incomes derive same from investments in quarters of the globe which would never contribute directly to the revenue of the British Government except through a tax levied against the income of the individual resident Briton, but there is a very grave doubt of the advisability of any such form of taxation in America where existing fortunes are actively at work in the development of industries of common benefit.

In commercial operations under a sales tax it will probably be found that prices of producers and wholesalers are considered to be or are quoted as plus tax and that the amount of the tax—that is, the 1 per cent, if such is the rate—will be added to the bottom of the invoice. The retail merchant, because his transactions are smaller and more individual, not desiring to collect a specific tax on each sale, and not being obliged to

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make such collection (as he is in the instance of the present luxury tax) will probably find it most advantageous to treat the tax as an element of expense, adding same to the percentage figure which he uses as his cost.

Retailers are accustomed to assembling items of expense, such as rent, wages, advertising, etc., and to represent same by a percentage figure which they add to the cost of an article to ascertain their cost beyond which to fix a selling price showing some margin of profit. Say a given retailer's cost of doing business is 24 per cent he might change that figure to 25½ per cent, including the sales tax in his cost at a rate to cover the tax on his selling price, which is higher than the cost price to which the percentage has been applied.

It is also possible that in certain lines of business or classes of commercial operations the sales tax, instead of being added at the bottom of an invoice, will be covered by a shortening of 1 per cent in the discount terms.

As an illustration: goods customarily sold on terms of 1 per cent off 30 days might be sold on terms of net 30 days, the seller absorbing the tax in return for the eliminated discount.

Sales taxes so adjust themselves where in operation and a sales tax of a small percentage would readily so adjust itself and soon become a matter of course, as are at present a great variety of selling terms and discounts which are in operation in different lines of trade.

A tax of a uniform percentage on sales of commodities, with no distinction between classes of commodities or stages of manufacture does not require any adjustment to varying degrees of profit in various lines of business between different dealers in the same line.

Whether the profit is 5 per cent or 10 per cent or any other percentage, the tax is not upon the profit but upon the sales and may in either event be passed along and will undoubtedly so tend to pass along in industries where the margin of profit is narrow, while tending more or less to be absorbed in industries where the margin of profit is broad.

I would, therefore, respectfully recommend as a means toward reform in Federal taxation that the excess profits tax on corporations be abandoned and that individual income surtaxes as applied to earned income be removed, that the normal income tax upon corporations and individuals be revised either as to rate or exemption, that the surtaxes upon unearned income be applied only after a somewhat increased exemption beyond the present $5,000, and that the bulk of the government revenue be obtained from five sources: (a) income from customs, which is now growing with the increase in importations; (b) certain excise taxes of established revenue producing power; (c) a tax on sales of commodities of a percentage probably 1

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per cent; (d) a normal tax on all incomes of whatever character above the exemption; (e) surtaxes upon unearned incomes.

I would also respectfully recommend that in connection with existing inheritance taxes the tax be levied against the beneficiary, or inheritor, based on the amount which he receives, but collectible out of the estate as a whole before distribution, in place of the present method of levying the tax against the estate.

Five hundred thousand dollar estate left to a widow and one child bears the heavy surtaxes applicable to an estate of that size, but the hardship is not great, as there are only two heirs, each receiving in an equal distribution a large amount. Where an estate of the same amount, $500,000, is left by a man of large family, however, and divided among a wife and perhaps six or seven children and one or two other dependents, the average amount received by each being about $50,000, the application of the surtax on the $500,000 estate to each one of these small inheritances is a grave injustice.

To base the tax on the amount inherited will restore equity and at the same time accomplish the useful social purpose of tending to break up and cause the division of very large estates.

REPORT OF COMMITTEE ON TAXATION NATIONAL ASSOCIATION OF MANUFACTURERS[1]

War increased the expenses of government tremendously. To meet these expenses, we not only derived more revenue from usual sources, but new revenue resources were discovered, most notable of which were excess profits, a totally new form of revenue.

The 18th Amendment deprives the government of an annual revenue of some $500,000,000. This demands that we review and revise our schedules to make up this permanent deficit, and provide an adequate certain revenue for the future.

The purpose of taxation should be to provide revenue. Obviously those forms which produce revenue for the maintenance and operation of government should be adequate. In this view lies the real danger, since it tempts us to make certain emergency taxes the basis of a permanent system.

Temporary results are notably untrustworthy. Too often they mislead into a belief that a system immediately successful will remain continuously and permanently so. We continue it and

[1] Proceedings of the Twenty-Fifth Annual Convention of the National Association of Manufacturers of the United States of America. May 17-19, 1920. p. 14-22.

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only after irreparable injury has been done is it repealed. We must remain alert to the by-products of the systems we are interested in. We must search, uncover, and accurately determine the growing tendencies and certain defects obtaining in that system, however successful it may seem. If our investigation into a revenue system shows that the flood of revenue from a particular source endangers that source; if the flood loses substance in its tortuous course and merely trickles into the Federal Treasury, and if we find it affecting seriously the very people whom it was designed to serve, we would be loth to continue it.

Thus stands the record of the excess profits tax.

This tax was adopted as a temporary measure to meet the emergencies brought about by the war, predicated upon foreign experience. It was serviceable as sixth. We are now endeavoring to get back on a substantial before-the-war basis; we must get rid of all expediencies which tend to interfere with our future industrial and equipment development.

Congress should devise a more satisfactory program of taxation, achieve an economically safe, sound, productive system of revenue—a system such as will help the government without hampering industry and thereby help the public. As such, the excess profit tax will not serve. The new tax must be one which will provide certain adequate revenue and yet insure industrial and public prosperity.

Those who advocate the repeal of the excess profits tax are impelled by unselfish motives. They are, for the most part, men who have placed national welfare above selfish partisan interests. After a practical experience with this tax and its effect upon capital, upon labor, upon production, upon price and the enormous expense in preparing tax returns and collecting such a tax, they are asking for a speedy appeal of this measure.

To mention some of the objections, we find the following significant indictments:

The excess profits tax:

1. Deprives industry of the fruits of its foresight and sagacity.
2. It burdens brains, ability and energy.
3. It discourages production.
4. It penalizes enterprise and ingenuity.
5. It interferes with the accumulation of industrial capital for the development of business.

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6. It encourages wasteful expenditures.

7. It puts a premium on over-capitalization and a penalty upon conservative business practice.

8. It discourages new ventures and confirms old ventures in their monopolies.

This last is particularly significant. Since all industries grow from small beginnings, they need encouragement and resources in the form of profits for future development. But the excess profits tax deprives industry of these encouragements and resources, repressing development and checking enterprise in its very beginning.

Again, the profits of capital are the wages of efficient enterprise. These profits are not pocketed, but are reinvested for further development and promotion of the enterprise which gives employment to labor. Therefore, it seems a mistaken policy to maintain a system of taxation which disturbs and obstructs general prosperity.

There is another serious objection to the excess profits tax. It operates as a cost plus system and has the same effect. It induces waste and extravagance throughout industry. It discourages efficiency in both the ranks of capital and labor.

As far back as 1776 Adam Smith arranged the fundamental principles of a just and useful tax. These maxims of taxations are:[1] (1) a tax ought to take out of the pockets of the people as little as possible over what it brings into the public treasury. It ought not be eaten up in salaries of a great number of officers. (2) It ought not obstruct industry which gives maintenance and employment to multitudes. (3) It ought to be fair and, therefore, not offer temptation to evade. (4) It ought to be easy to compute and to collect. Furthermore, in a popular government, any system of taxation proposed with a view of convincing the public at large that the tax burden imposed is paid by a limited few tends to demoralizing and extravagant expenditure on the part of government, the burden of which ultimately must fall upon all if the country is to be prosperous and business enterprise thrive.

The excess profits tax violates these fundamental principles of a just and useful tax. The cost of collecting the present tax is about $40,000,000. It is so intricate that few understand it. It represses industry; and a variety of schemes have been created

[1] For a fair and exact statement of Adam Smith's maxims, see Part I.

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to evade it. It bears none of the qualities of a just and useful tax.

The economic welfare of the country demands an immediate repeal of the excess profits tax. But its repeal demands also that a satisfactory substitute be found. This substitute tax must have certain specific advantages of a just and useful tax to recommend it at this time. It must produce adequate revenue, must be easily administered, must be inexpensive, must impose no unnecessary burdens anywhere, it must discourage waste and extravagance, it must promote prosperity.

At the time of the Civil War our government was confronted by a revenue problem similar to the present. It resorted to a tax on sales which was called an excise tax, imposed upon a limited number of commodities.

It operated as a tax on sales and was very simple in operation.

In addition to this excise tax there was a special retailer's tax and wholesaler's license tax of $10 and an income tax of 5 per cent. These three taxes were paid annually.

On account of its limited application and the increased revenue derived from customs, this tax was repealed except in the case of liquors and tobacco, articles of luxury.

We feel that possibly the solution of the present problem lies in a carefully devised gross sales tax. Such a tax would admit of many variations. But it seems the most reasonable form would be a limited tax on turnovers of wares, goods and merchandise.

Such a slight tax on articles of wide consumption would have small effect on the resources of the consumer.

A tax of 1 per cent on every sale of beef, from the hoof to the consumer, would produce an annual revenue of $60,000,000. Yet it would amount to little more than ¼c. per pound on the purchase price to the consumer and consequently would likely be borne by the retailer. This same principle would apply in the same way to many other articles of wide consumption. Still it would produce sufficient revenue to obviate the excess profits tax, yet entail no hardship upon the consumer.

It seems impossible to secure at this time any reliable figures of gross sales, but the estimated gross sales for the year 1919 was approximately $672,000,000,000 after the elimination of returns, allowances and intercompany sales. A 1 per cent sales tax on this amount would produce an annual revenue of

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$6,720,000,000 which exceeds the amount called for in the national budget. More conservative estimators figure the gross sales as $200,000,000,000, and even on this basis a 1 per cent tax would yield a yearly tax of $2,000,000,000.

We would, therefore, suggest that a gross sales tax on all sales of wares, goods and merchandise by individuals, partnerships and corporations and some forms of public service *be accorded serious consideration.*

The individual, partnership or corporation should secure a license from the government to entitle him to do business, somewhat along the lines of the license now granted to tobacco dealers, for which a nominal charge should be made. This is to place on record those engaged in business and as a check to force tax returns.

The tax on sales would be a tax on the sales as recorded on the books of any individual, partnership or corporation, large or small, and the exhibits hereto appended show how this would be added as a direct percentage in billing and estimating as an item of expense in fixing prices.

A simple form could be prepared showing the net sales, eliminating returns, allowances and intercompany sales, this statement to be executed by a notary public or other authorized official and sent to the revenue office with a check covering 1 per cent of the sales. This would cause a steady flow of revenue and overcome the necessity of the government borrowing money except in rare emergencies.

In view of the revenue that could apparently be derived from a gross sales tax, we respectfully suggest that the present forms of federal taxation be changed or revised and that the following plan be given careful consideration in amending the system to deal more efficiently with the problems at hand:

1. A straight tax of 1 per cent upon all sales of goods, wares and merchandise by individuals, partnerships, corporations and some forms of public service corporations.

2. A normal tax of 4 per cent on all incomes of whatever character over $2,500 for single persons and $5,000 for married.

3. Income from customs.

4. Certain excise taxes of established revenue-producing power.

We believe this gross sales tax would be a just, certain and adequate source of revenue.

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1. It will be fairly distributed over a great mass and through the year so as to be scarcely noticeable.

2. It will reach many who should pay taxes but who now escape them.

3. It would be definite and easily ascertainable.

4. It could be collected monthly or quarterly.

5. Excess profits tax is unproductive during a depression; while the gross sales tax is certain at all times.

6. Competition will automatically safeguard the consumer against tax profiteering.

7. It would not be discriminatory; it would be fair to all businesses.

8. It will tempt free capital now driven into non-taxable securities to liberal investment in productive industry.

This tax would give to business the stimulus it now needs and would help put economic America on a substantial basis and go far toward promoting permanent prosperity.

AN INCOME TAX LESSON[1]

More or less startling newspaper headlines have recently announced the fact that sixty-five individuals reporting taxable income for the calendar year 1919 filed returns showing income of $1,000,000 or more. This fact, stated by itself, may loom large in the popular estimation. It seems to convey an idea of vast wealth in the hands of a few. The headlines failed to point out that for the calendar year 1916 the income tax returns disclosed income of $1,000,000 or more for two hundred six individuals. In other words between 1916 and 1919 there was an elimination of one hundred forty-one taxable incomes of $1,000,000 or more.

In 1916 the records show that three hundred seventy-six persons reported income of between $500,000 and $1,000,000, while in 1919, the reports included only one hundred eighty-nine. The decline in the number of large incomes continues down to the record of income from $150,000 to $200,000, of which there were 1,284 returned for 1916 and 1,092 for 1919. Incomes less than $150,000 showed uniform increases from 1916 to 1919.

Does this mean that the very rich are getting poorer and the comparatively poor are getting richer? Not necessarily by any

[1] Wall Street Journal. July 27, 1921.

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sane accounting. It chiefly means that the incidence of high surtax rates since 1916, in the effort to tax the very rich disproportionately, has driven reinvestment of income of the very rich out of business channels into tax-exempt securities. It means that the extremely rich prefer to invest in 4 per cent or 5 per cent tax-exempt municipal and state securities rather than invite the trouble and risk of embarking in business enterprises that must yield 17 per cent or more in order to be equivalent to a 4 per cent tax-exempt investment.

In 1916, the income reported in excess of $150,000 was $1,498,832,392, comprised in 3,833 returns. In 1919, the reported income in excess of $150,000 had shrunk to $811,160,125, comprised in 2,543 returns—a decline of $687,672,267 in income and of 1,290 returns.

This shrinkage was not due to hard times, for 1919 was notoriously a better year than 1916. One indication of this is that net returns by individuals with $3,000 to $150,000 income showed $12,411,931,807 in 1919 as against $4,799,745,228 in 1919, an increase of $7,612,186,579. The returns of $3,000 to $150,000 incomes in 1919 numbered 1,835,604, while the number in 1916 was only 433,203.

In the face of this general display of increased prosperity it is absurd to assume that the very rich did not share with the rest of the community in an enlargement of income. Neither is it conceivable that returns were falsified by the wholesale as soon as income passed the $150,000 mark. The simple answer is that the high surtax rates defeated their own purpose. Instead of taking toll from the very rich, as they were designed to do, they drove wealthy investors out of the business field into non-taxable investments.

The moral is equally obvious. Surtax rates must be reduced to a point where they will not kill the geese that should lay golden eggs for the support of government, and an end should promptly be put to the constant enlargement of the tax-exempt pasture.

BRIEF EXCERPTS

For one hundred fifty years this country subsisted on consumption taxes. They were the only kinds that we paid. I refer

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to the taxes collected through the Custom House, and through the Internal Revenue bureaus. *Jules S. Bache. The Turnover Tax—The Only Way Out. p. 9.*

The advantages of this tax would be that it would be equally paid by everybody in the country, and might lead, perhaps, to thrift, since those who wish to avoid paying taxes would only have to decrease their expenditures. *Jules S. Bache. Bache Review. Special Edition. April, 1920.*

There aren't any two general sales taxes throughout the world which are the same. In the Philippines all farming products are exempted; in Canada, necessities of life are exempted; in France numerous other things are exempted; and so on. *Edwin R. A. Seligman. Proceedings of the Second National Industrial Tax Conference. p. 77.*

A sales tax, a turnover tax, is a consumption tax. As such, it has got to be passed on to the consumer. If it can not be passed on, it can not be levied. I can see no possible injustice to any company by their not being able to pass the tax on under these conditions, if those conditions are provided for. A sales tax is an overhead charge like rent, labor, clerk hire, and kindred expenses. *Jules S. Bache. Hearings before the Committee of Ways and Means. 1921. p. 84.*

The excess profits tax is a consumption tax pure and simple, and no possible device can make it anything else. Practically all taxes are consumption taxes. I don't know that Mr. Rockefeller is able to pass on his 73 per cent, but I know that most business men in this country are busy passing on their taxes, and if they didn't succeed in doing it, many of them would be bankrupt today. *Jules S. Bache. Proceedings of the Second National Industrial Tax Conference. p. 57.*

A sales tax would undoubtedly be highly productive of revenue; it would, I believe, diminish the "loading" of prices; it would be free from the injurious effects of other taxes on the natural flow of capital; it ought to be relatively simple of collection; it would not require the employment of lawyers and accountants by the taxpayer and the irritating and worrying work of grappling with intricate schedules; it could be paid as

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it accrues, say at the end of every month, instead of being ascertainable only at the end of the year and payable thereafter. *Otto H. Kahn. Addendum to Some Suggestions on Tax Revision and the Sales Tax. p. 26-7.*

Even if the theorist who believes in levying the bulk of taxation on the man who can most easily pay—viz: the man with the largest income—is correct in his belief, his purpose is defeated by the fact that the man with the large income seeks the protection of the tax-exempt security, and leaves that man to bear the greatest burden who, even with heavy income taxes, is not willing to become a drone, but keeping his money in commerce for his own advancement and the up-building of the country, does not seek that protection. Therefore, in this country, I am unalterably opposed to the income tax in any shape whatever. *Jules S. Bache. Address before Retail Merchants of Detroit.*

The sales tax is not a novel tax. The Romans had it, not to speak of the Egyptians and the Babylonians. The sales tax has existed in one form or another for a great many years, with only two exceptions, it has been abolished everywhere and has not been re-introduced in any first class country—and those two exceptions are Germany, which re-introduced it in 1919, and France, which introduced it in 1920. We can learn little one way or another, either for or against it, from Mexico or Cuba or the Philippines or Canada, all of which are countries of insignificant economic proportions, where we do not find the real kind of sales tax that we have been discussing today. *Edwin R. A. Seligman. Proceedings of the Second National Industrial Tax Conference. p. 72.*

Our suxtaxes go to 65 per cent. There is in addition 8 per cent normal tax, making a total maximum tax of 73 per cent. It is an extreme rate which I think may fairly be said to be impossible, impracticable in times of peace.

For the year 1916, when the tax rate was low, there was reported by taxpayers having a net income of $300,000 over $992,000,000 of net income. That is, in 1916, the year when our tax rates were relatively low. By 1918—that is to say, in two

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years, and good years—the amount of net income reported by taxpayers having incomes of $300,000 or over had fallen to $392,000,000. It seems to me the common sense of the situation indicates that we can not successfully enforce tax rates running to 73 per cent. *Thomas S. Adams. Hearings before the Committee on Ways and Means. 1921. p. 10-11.*

That the results in question are assured is proven by the experience in the Philippines, where the [sales] tax has been in operation since 1905, and where under no circumstances would its repeal be contemplated for a moment, and where an increase in the rate of from 1 per cent, at which it is now being levied, to 2 per cent is being discussed with popular approval, in order practically to abandon all other types of taxation. In its initiation in the Philippines the very same objections were raised against it, as are being made here now. Mass meetings were held and parades were formed in antagonism to the innovation. Three months after the tax had been put into operation and was working, not a murmur was heard against it, and today a revolution would occur if any attempt were made to repeal it. *Jules S. Bache. The Turnover Tax—The Only Way Out. p. 6.*

The tax on retail sales paid by the consumer is the most disturbing, irritating and altogether unpopular method of collecting taxes perhaps ever invented. It is the mustard gas of taxation.

It is illustrated in the soda water tax, where, for every 15c. drink, the public has to get a little pink ticket and pay 2c. more for it—a most outrageous tax; over 13 per cent—but the annoyance and inconvenience is almost worse.

This does *not* describe the tax on *gross sales,* or turnover. In this turnover tax, the *seller,* not the buyer, *pays.* This is the way it would work:

The merchant or seller would take from his books once a month the total amount of his sales and forward the statement to the collector with his check for 1 per cent of such sales. This would be the method all along the line. *William C. Cornwell. An Intolerable Situation. p. 11-12.*

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Congressman William R. Green. You think that business men know all about the science of taxation.

Mr. Jules S. Bache. I do not think anybody else does. I do not think there is a science of taxation.

Mr. Green. You do not think there is?

Mr. Bache. No, sir.

Mr. Green. I had come to the conclusion, since you were talking, that that was your opinion.

Mr. Bache. I dispute the words "science of taxation." There is slavery of taxation. Taxation is a burden which we must all bear.

Congressman Henry T. Rainey. Taxation has been defined to be a method of getting the most feathers with the least squawking of the goose.

Mr. Bache. I agree to that. The sales tax will do that. There is no tax in the world that will ever get so much money. *Hearings before the Committee on Ways and Means. 1921. p. 87.*

I have analyzed the fiscal situation in a concrete way, and if you will permit me to I would just like to make these three observations regarding it:

First. That the $24,000,000,000, the real aftermath of the war, represented by various interest-bearing securities, really mean a mortgage on each family in America of $1,200 if we divide the total debt among the twenty million families constituting the Nation's population.

Second. That the annual carrying charge on that mortgage means $50 per family, or $10, on the average, annually, on every man, woman, and child in the country.

Third. If we are to operate on a $4,000,000,000 appropriation or budget for four years, as was suggested by Secretary Houston, that means that every man, woman, and child in this country, on the average, during each of these four years must somehow or other provide $40; or, in other words, each American family—a family consisting of five members in accordance with the familiar census type—would somehow or other have to manage to provide $200 per year to meet the fiscal requirements of the country. *J. J. Klein. Hearings before the Committee on Ways and Means. 1921. p. 69-70.*

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Federal revenue from all forms of internal taxation in the fiscal year 1921, which ended July 1, decreased $812,579,486, compared with the government's internal taxation receipts the year before. This was disclosed today by a preliminary report from D. H. Blair, commissioner of internal revenue, to the secretary of the treasury.

Commissioner Blair's report shows that collections from income and excess taxes, which constitute almost three-fourths of the internal taxation yield, decreased more than $700,000,000.

A recapitulation of the internal revenue receipts from all tax sources for the fiscal year 1921 follows:

Tax Sources	1920	1921
Income and profits	$3,956,934,499	$3,225,790,653
Estates	103,635,563	154,039,902
Transportation and insurance	307,769,841	320,504,167
Beverages	197,332,105	141,295,508
Tobacco	294,777,051	253,990,016
Admissions and dues	81,918,556	95,882,345
Excises	267,882,602	229,331,657
Capital stocks, etc.	105,479,925	92,446,376
Stamp taxes	84,347,827	72,468,013
Child labor employment	2,380	24,223
Miscellaneous, including national prohibition.	7,499,898	9,237,900
Total	$5,407,580,251	$4,595,000,765

Cleveland Plain Dealer. August 29, 1921.

The collection of internal revenue taxes for the fiscal year 1920 and selected prior years are summarized in the following table:

Sources	1920	1919	1918	1914
Distilled spirits	$97,905,275.71	$365,211,252.26	$317,553,687.33	$159,098,177.31
Fermented liquors	41,965,874.09	117,839,602.21	126,285,857.65	67,081,512.45
Tobacco	295,809,355.44	206,003,091.84	156,188,659.90	79,986,639.68
Oleomargarine	3,728,276.05	2,791,831.08	2,336,907.00	1,325,219.13
Capital-stock tax, including other special taxes	102,933,701.35	33,497,047.82	27,281,269.12	....
Miscellaneous and war excise taxes	883,863,871.82	513,823,884.14	225,973,363.44	1,136,070.65
Stamp sales for parcel-post packages, etc.	24,437,893.75	10,199,466.51	4,336,182.21	....
Income and excess-profits taxes	3,956,936,003.60	2,600,783,902.70	2,838,999,894.28	71,381,274.74
Total receipts	5,407,580,251.81	3,850,150,078.56	3,698,955,820.93	380,008,893.96

Annual Report of the United States Commissioner of Internal Revenue. 1920. p. 8.

I had occasion to look over the report of the Commissioner of Internal Revenue, I think, for 1917, and when the incomes

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reached $4,000,000 or $5,000,000, then there is no change, there is no difference, between the surtax on $5,000,000 and that of $6,000,000, $7,000,000, $8,000,000, or $10,000,000, or any sum above $5,000,000. Then I turned to the page where it was given in States the number of people who paid taxes on income of more than $1,000,000. I found there was not a man in the State of Michigan who paid taxes on incomes of more than $4,000,000, although we know there are several men in the State of Michigan whose income is figured above $4,000,000 a year. It is evident they are either investing their money in tax-free securities or adding to the plants and failing to distribute the profits. That would happen. I know of one in particular, whose income is very great, who has added many million dollars' worth of additions to his plant, invested several million dollars, and, of course, employing a large number of men. He must not be criticized for that; for that he should be complimented, but with an income of $30,000,000 to $50,000,000 a year he did not pay taxes on an income of more than $4,000,000. It is evident he has been investing in tax-free securities, in my opinion. *Joseph W. Fordney. Hearings before the Committee on Ways and Means. 1921. p. 15.*

TABLE SHOWING TOTAL NUMBER OF PERSONAL INCOME-TAX RETURNS FILED FOR THE CALENDAR YEAR ENDED DECEMBER 31, 1918, DISTRIBUTED BY INCOME CLASSES

Income Classes			Number of Returns
$1,000	to	$2,000	1,516,938
2,000	"	3,000	1,496,878
3,000	"	4,000	610,095
4,000	"	5,000	322,241
5,000	"	6,000	126,554
6,000	"	7,000	79,152
7,000	"	8,000	51,381
8,000	"	9,000	35,117
9,000	"	10,000	27,152
10,000	"	11,000	20,414
11,000	"	12,000	16,371
12,000	"	13,000	13,202
13,000	"	14,000	10,882
14,000	"	15,000	9,123
15,000	"	20,000	30,227
20,000	"	25,000	16,350
25,000	"	30,000	10,206
30,000	"	40,000	11,887
40,000	"	50,000	6,449
50,000	"	60,000	3,720
60,000	"	70,000	2,441
70,000	"	80,000	1,691
80,000	"	90,000	1,210
90,000	"	100,000	934
100,000	"	150,000	2,358
150,000	"	200,000	866

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Income Classes			Number of Returns
$200,000	"	250,000	401
250,000	"	300,000	247
300,000	"	400,000	260
400,000	"	500,000	122
500,000	"	750,000	132
750,000	"	1,000,000	46
1,000,000	"	1,500,000	33
1,500,000	"	2,000,000	16
2,000,000	"	3,000,000	11
3,000,000	"	4,000,000	4
4,000,000	"	5,000,000	2
5,000,000	and	over	1
Total			4,425,114

Statistics of Income. Compiled by United States Commissioner of Internal Revenue. 1921.

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NEGATIVE DISCUSSION

SALES OR TURNOVER TAX[1]

It is not advisable under present conditions to resort to any one of the several forms of a sales or turnover tax of general application which are being proposed.

The Committee approached in the most hopeful spirit the proposal that our tax system could be greatly simplified and perhaps the greater part of the necessary revenue could be raised through the adoption of some form of a general sales tax. It is no exaggeration to say that most of the members of the Committee at the outset were rather predisposed in favor of a general sales tax, and it was with the greatest reluctance that the Committee reached the conclusion that such a tax does not offer a satisfactory solution of the taxation problem.

Forms of Sales Tax Now Being Proposed

The several proposals for a sales tax of general application fall into three groups:

1. A tax on every sale or turnover, not only of commodities but also of services, real property, capital assets, etc., and on rent and interest.
2. A tax on every sale or turnover of goods, wares and merchandise (i.e., limited to commodities).
3. A tax on all final sales of goods, wares and merchandise for consumption or use.

The first two are of much the same nature, differing only in the scope of their application, and can well be considered together, after which the third will be taken up. In discussing this entire question it is to be borne in mind that the comparison is not with the existing objectionable excess profits tax, the repeal of which the Committee joins in recommending, but rather with an increase in the corporation income tax, the documentary stamp taxes, customs duties and the sales taxes on specified commodities.

[1] Report of the Tax Committee of the National Industrial Conference Board on the federal tax problem. p. 12-31.

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Reasons for Not Approving Turnover Tax

The more important of the reasons which have led the Committee to its conclusion after hearing and giving the most careful consideration to extended arguments on both sides are:

1. There is great uncertainty as to the form such a tax would finally take, as well as to the rate necessary to raise the required revenue.

Various advocates of a general turnover tax estimate that a 1 per cent tax on all turnovers would produce from $1,500,000,000 to $5,000,000,000. If the tax is limited to 1 per cent on the turnover of goods, wares and merchandise alone, the estimates go down to as low as $750,000,000. One of the best known advocates of the sales tax states that no one can estimate within $1,000,000,000 what such a tax would produce. Mr. Joseph S. McCoy, in a letter to the Committee dated September 6, 1920, estimates that from a tax of 1 per cent covering sales of all kinds by traders, manufacturers, mines and farms, $1,100,000,000 should, with careful administration, be collected. If to this is added sales of real estate, sales of the use of real estate (rents), amusements, sales by hotels, including prepared food, lodging and service, advertisements, securities, etc., he estimates that this would be increased to about $1,575,000,000. It is important to note, moreover, that he says his estimates are based upon every available source of information, *which is, however, very meagre.* The Committee does not feel it advisable to levy a tax the revenue from which no one can reasonably forecast and which its very proponents admit might produce $1,000,000,000 more than was anticipated. This tax must be paid in the first place by business, whether it is eventually passed on or not. It is not believed that business men desire to pay or even collect for the Government perhaps twice as much revenue as may be required.

Experience in such other countries as have introduced some form of general turnover tax, such as the Philippines and Canada, indicates that Congress would find it necessary to yield, as they have, to pressure and make important exemptions, such, for instance, as the initial sale of farm products. If this were done the yield of the tax would be greatly reduced, and it is not improbable that the basic rate would be set at 2 per cent or higher, and that still higher rates would be applied to the sales of less-essentials and luxuries. The Canadian act, for example,

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in addition to the basic rate, levies additional higher rates on specific articles such as:

3% on chewing gum.
5% on pianos.
10% on articles of clothing, carpets, rugs, robes or sporting goods over a fixed value, boats, yachts, cameras, confectionery, fire arms, cartridges, pianos over $450, other musical instruments, lighting fixtures, certain articles of cutlery and toilet articles, cut glassware, clocks and watches, walking sticks, etc.
15% on automobiles retailing for not more than $3000, oriental rugs and antiques, certain articles of furniture and chinaware.
20% on automobiles retailing for more than $3000, jewelry over $5 in value, certain toiletware, liveries, hunting garments and knives, smoking articles, certain patent medicines, perfumes, etc.
50% on certain articles of gold.
Taxes at specific rates on other articles.
An annual license tax for selling or dealing in any of these articles.

It is not improbable that if Congress should undertake to frame a law taxing the sale of every article, it would be inclined to impose higher rates on less essential articles similar to those in the Canadian law, nor would Congress be likely to reduce luxury taxes while it was imposing a tax on the sale of necessities.

It has been suggested that bankers, brokers and commission men should be taxed, not on their sales, but on their commissions or gross profits; and such an exception might be necessary. If this were done, it is reasonable to expect that Congress would impose some other tax upon these classes of business and that if such a tax were imposed on them it would at least be as burdensome as the tax on other classes of business.

One advantage which the sales tax possesses is that it would be comparatively easy for any business organization to determine what it would have to pay. It is urged that because the amount of the tax is easily determinable it could be paid monthly or quarterly upon the sales of the preceding month or quarter on the pay-as-you-go principle, and the accumulation of a tax obligation to be paid in the following year could thus be avoided. If such a tax law were passed, applying to the sales of 1921, business men would have these payments to make in addition to meeting the payments of the excess profits and income taxes levied upon the income of the year 1920, which must be paid during 1921.

2. A turnover tax would be a large tax, not a small tax.

It is frequently stated by the advocates of the tax that 1 per cent on every sale is such a small amount that certain admitted inequities in its operation are negligible. The tax is advocated, however, to produce enought revenue to replace the

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excess profits tax and materially reduce the surtaxes on personal income. The figure most commonly named is $2,000,000,000. As pointed out above, it is probable that to produce such a revenue the basic rate would have to be 2 per cent or higher. It must be borne in mind that the tax will be collected entirely from business and that this amount of revenue is more than double what would be secured from the excess profits tax. In spite, therefore, of the illustrations of individual cases based upon a 1 per cent rate, the tax as paid by the average business organization would be a very large amount. A tax of only 1 per cent of his gross sales levied upon a merchant who turns his stock four or five times a year would in many cases equal or exceed 40 per cent of his net profits.

3. The uncertainty as to whether or not the tax would in fact be shifted to the consumer, and the advantage it would give to the multiple-process organizations would be most serious in their effect upon business.

There is some disagreement among the advocates of the sales tax as to the extent to which it would be shifted. Some assert that unless the tax is shifted it has little in its favor, and that in cases where there is a reasonable doubt whether it would be shifted, it should not be imposed. Others maintain that it will be shifted or not, according to competitive conditions, because such a tax would be a generally recognized item of cost. The first element of uncertainty as to the extent to which the tax would be shifted arises from the fact that certain competitors would pay it to a greater extent than others engaged in the same industry.

Those advocates of the sales tax who admit it can not always be shifted, assert that it will be shifted when competition permits and will not be shifted when competition does not permit, just as would be the case in any other item of cost. They compare this tax to the payment of rent, stating that every business man has to shift his rent through the selling price of his goods. In considering this argument we must bear in mind the change that has occurred in business conditions and not to be misled by the experience of the last few years, during which it was comparatively easy for most businesses to shift any advancing item of cost with a profit added. The country has passed from a sellers' market to a buyers' market. Items of advancing cost can not be readily passed

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on to the consumer. It is conceivable that even an advance in rent might come out of profits in special situations where it would be impossible to advance the selling price sufficiently to cover it. A merchant with a stock of goods on hand on which the prices were declining might find it difficult to advance his prices enough to cover the tax. Business men generally are confronted with the necessity of reducing their costs in order to be able to sell their product at prices which will encourage purchases by consumers. Such a tax would stand in the way of this purpose. It seems undesirable that the tax be shifted when competition permits, and not shifted when competition does not permit. When business is good and the demand is strong and, consequently, competition not keen, the tax could be shifted. That is the very time when a business is making a profit and can afford to pay a tax. When the demand falls off and competition grows so keen that the tax cannot be shifted, how can it be paid? Under such conditions there may not be any net profits from which to pay it. It would be added as an item of cost to the losses which might bring insolvency.

4. To the extent that a sales tax is not shifted it becomes a tax on gross income, which is entirely inequitable as between various classes of business.

The Committee believes that a tax upon gross income would be more burdensome than a tax upon net income. The inequity of a tax on turnover or gross income as between a business which turns its capital once in several years and another which turns its capital several times a year—provided the tax cannot be entirely shifted—is too great to be borne.

The statistics of taxable income for 1917, the latest year for which a report has been issued by the Bureau of Internal Revenue, indicate that in that year the total gross income of manufacturing corporations was $40,437,000,000, and the total taxable net income was $5,736,000,000. The total gross income of trading corporations was $19,804,000,000, and the total taxable net income was $1,481,000,000. Assuming that the gross income did not greatly exceed the total sales, a tax of only 1 per cent upon the gross would be equivalent to 7 per cent on the net in the case of manufacturing corporations, and 13.4 per cent on the net in the case of trading corporations. It will be noted that these percentages are only an average and that

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while in some individual cases they would be lower, in many other cases they would undoubtedly be higher.

To illustrate the effect of the tax, manufacturing corporation A, which employs in its business a capital of $1,000,000, makes a net profit of $100,000, and has an annual gross income of $500,000, might be compared with trading corporation B, which employs the same amount of capital, makes the same net profit and has an annual gross income of $5,000,000. A turns its capital once in two years. B turns it five times in one year. At a rate of 1 per cent A would pay a tax of $5,000, which is ½ of 1 per cent of the capital employed, or 5 per cent of its net income. B would pay $50,000, which is 5 per cent of the capital employed and 50 per cent of its net income. One of the two businesses with the same investment and the same profits would pay a tax ten times as large as the other. This illustration is not extreme. There are numerous businesses involving large investment and many processes where the capital employed is not turned over as frequently as in the case of A. On the other hand, it is a well-known fact that it is common practice in certain lines of business for retailers to turn their capital as often as ten times annually.

The conclusion thus indicated is confirmed by some very interesting figures supplied by one of the members of the Committee. He directed one his assistants to run through his client files and to schedule the gross sales and net income in each case where the file included a copy of a recent income tax return. In this way he secured exact figures for twenty-six concerns located in all parts of the country, engaged in seventeen different industries, selected entirely by chance, and representing, it is thought, the typical "run of the mine." (For complete schedule see Appendix B.)

These few concerns afforded three instances where a tax of only 1 per cent of the gross sales would have been equivalent to between 20 per cent and 30 per cent of the net income, and sixteen other instances in the past three or four years where such a tax would have been equivalent to between 5 per cent and 20 per cent of the net income. These are actual figures of actual cases. It is startling to contemplate the disparity in these cases if the taxpayer should happen also to be unable to shift the tax to the consumer.

The Committee is forced to the conclusion that a tax on

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net income is a far safer one for business than a possible tax on gross income, and that, after the abnormal years we have passed through, it is unwise to risk embarking upon such a dubious experiment at a time when every effort should be directed toward regaining normal and more stable conditions.

5. It would be an unfair discrimination to relieve corporations of all but the sales tax, while compelling partnerships and sole proprietors to pay normal income and surtaxes on their business income.

Under existing tax laws corporations pay an excess profits tax (the righest rate of which is 40 per cent) and an income tax of 10 per cent on the balance of the net income, while partners and sole proprietors pay on their entire income, including their business income, a normal tax of 8 per cent and surtaxes the highest rate of which is 65 per cent. The difficulty, amounting to practical impossibility, of separating the business income from the personal income of a partner or sole proprietor, has been demonstrated in the single year to which the Revenue Act of 1917 applied, under which the partnership and individual were subject to the excess profits tax. The Bureau of Internal Revenue is still loaded down with many unsettled cases turning on the question of what is or is not business income in the case of an individual. If, however, the partner and sole proprietor are not or cannot be entirely relieved of the surtaxes on business income, then when the excess profits tax is repealed some other tax should be levied on the income of corporations to compensate for the surtaxes paid by other forms of business. A sales tax paid by both would only add to the burden on the individual, and not in any way lessen the discrimination, because other forms of business would pay it in addition to the surtaxes.

The Committee recommends an increase in the corporation income tax as the simplest way in which the taxation on corporate income may be roughly equalized with the taxation of other business income, taking the latter to be saved and invested income subject to the reduced surtaxes recommended by the Committee.

6. A sales tax would tend to bring about undesirable changes in business practices.

The cases cited above, showing what would occur in the cotton industry, the shoe industry and the tool industry, illustrate the effect of a sales tax on small manufacturers and many classes

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of middlemen. It is to be questioned whether the Government should levy a tax which would be in effect a bounty on combinations and which would drive out of business many classes of so-called middle men who perform a service which is well worth what it costs. Devices to get around the tax through the avoidance of technical sales would be multiplied. Consignments of goods to selling agents instead of to wholesale distributors, contracts for future sales, leases and rentals would take the place of the economic process of a direct sale at each step of distribution. It is not thought that either manufacturers or distributors would welcome a situation in which, in order to avoid a tax on a technical sale, the manufacturer might be induced to consign his goods to wholesale dealers as his agent or, where his capital was not sufficient to do this, be required to meet the competition by paying not only the tax upon his own sale, but the tax upon the sale by the wholesaler. It is asserted that the cost of distribution would be reduced by the elimination of certain middlemen through the imposition of this tax. Even if this should be the case, is it just or proper or economically sound for such a result to be brought about by a temporary tax rather than by the natural development of a more efficient method of distribution? These results would occur regardless of whether or not the tax were shifted, because the business which avoided one of the taxable steps would secure that much additional profit if the market was based upon the costs of competitors who paid the tax and passed it on.

Assistant Secretary of the Treasury Leffingwell, in recently commenting on the difficulty of estimating the yield of the turnover tax, well said that such a tax would in five years revolutionize present methods of doing business, because means of getting around the intermediate turnover tax would be devised and put into effect. Can business men look with equanimity upon a temporary tax which may change business practices that have proved their economic soundness by surviving the stress of competition?

7. The administrative difficulties presented by a turnover tax are much greater than is generally realized.

It is true that the problems of reports and collection would be simple except for their multiplicity. Even with the exemption of street peddlers, boot-blacks and other small businesses,

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through establishing a minimum exemption of $500 per month, there would be millions of returns that would require a large force of field and office auditors to check up. New and complicated problems would arise in the definition of what is a sale. Leases, contracts for sale, commission and agency arrangements would be stimulated. The present practice in some lines, of renting or leasing out the product instead of selling it, such as now holds in the case of shoe machinery, adding machines, coffee urns, etc., is capable of being largely expanded. Such practices with the purpose of avoiding the payment of the tax would present considerable administrative difficulty. The administration of such a tax would raise serious problems, and the number of taxpayers would be so greatly increased that it would probably be difficult to prevent wholesale evasions.

The Bureau of Internal Revenue has experienced the greatest difficulty in building up and maintaining a sufficient force of field agents and auditors to close the income and excess profits returns of the last few years. If these returns are to be disposed of within anything like a reasonable time, the personnel of the Income Tax Unit cannot safely be depleted in order to build up the new organization required for this new kind of tax. It is essential to the success of such a tax that it be properly administered *from the very outset,* but the difficulties in the way of securing a sufficient and qualified personnel are so great as to constitute in themselves a very strong argument against its enactment.

8. The experience of other countries with a general sales tax, and the history of the movement for such a tax in this country after the Civil War, point inevitably to the conclusion that such a tax is a last resort, to be availed of only after other resources have failed.

The discussion now going on relating to a general sales tax is closely paralleled by the discussion of the same object after the close of the Civil War. At that time such a tax at first found widespread favor, but the proposal was finally abandoned after a careful study of the subject by the United States Revenue Commission, whose report to the Secretary of the Treasury was submitted by him to Congress January 29, 1866. The Committee is also advised that both Great Britain and Italy have given most serious consideration to the proposal of a general sales tax, and that in both countries the conclu-

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sion has been reached that such a tax is an absolutely last resort, to be availed of only in case all other sources of revenue prove inadequate. This despite the fact that the rates of the British normal income tax and of the business profits tax are higher than our own.

A general sales tax is not new, as is generally supposed. It has been tried by many countries in the past, but every leading nation which adopted it has abandoned it and never resumed its use, except in the present case of France and Germany, which have resorted to it as a last extremity after exhausting every other means of raising revenue. The most recent reports concerning the French "*taxe sur le chiffre d'affaires*" are distinctly unfavorable. This tax went into effect only very recently and is relied upon to yield only about one-fourth of the total amount which is being raised from internal taxation. The difference in the financial condition of France, and in the form and the expected yield of the tax itself, and the French experience during the short time it has been in operation, are not factors encouraging to the adoption of a general sales tax in the United States.

The Committee has not, however, overlooked the fact that modified forms of sales taxes are actually in effect in the Philippines and Canada, and in particular that favorable reports are reaching this country relative to the operation of the new Canadian taxes.

Conditions in a country like the Philippines, where, aside from agriculture, productive industry plays such a small part, are so different from those in the United States that a comparison possesses little value. It is interesting to note, however, that the Philippine tax is called a "Percentage Tax on Merchants' Sales," and that exemptions from the tax include:

1. Merchandise actually exported by the vendor;
2. Things, other than opium, subject to specific tax;
3. Agricultural products when sold by the producer or owner of the land where grown, whether in their original state or not.

It would appear that a very large part of this tax revenue is probably derived from sales of imports.

The Canadian tax is in form a tax upon sales of finished articles by manufacturers, wholesalers and jobbers. It is so coupled, however, with other taxes upon the sales of a great variety of specified commodities at rates of 3, 5, 10, 15, 20 and

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50 per cent, in addition to a license tax on sales, and with such a long list of exemptions, that it has little resemblance to the proposal in this country for a general turnover tax.

Exemptions from the Canadian sales tax include: Animals, living; poultry, fresh or salted; pickled, smoked or canned meats; canned poultry; soups of all kinds; milk, cream, butter, cheese, buttermilk, condensed milk, condensed coffee with milk, milk foods, milk powder and similar products of milk; oleomargarine, margarine, butterine or any other substitutes for butter; lard, lard compound and similar substances; cottolene; eggs; chicory, raw or green, kiln-dried, roasted or ground; coffee, green, roasted or ground; tea; hops; rice, cleaned or uncleaned; rice flour; sago flour; tapioca flour; rice meal; corn starch; potato flour; vegetables, fruits, grains and seeds in their natural state; buckwheat, meal or flour; pot, pearl, rolled, roasted or ground barley; corn meal; corn flour; oatmeal or rolled oats; rye flour; wheat flour or wheat meal; sago and tapioca; macaroni and vermicelli; split peas and pea meal; cattle foods; hay and straw; nursery stock; vegetables, canned, dried or desiccated; fruits, canned, dried, desiccated or evaporated; honey; fish or products thereof; sugar; molasses; maple, corn and sugar-cane syrups and all imitations thereof; ice; newspapers and quarterly, monthly and semimonthly magazines and weekly literary papers unbound; gold and silver ingots, blocks, bars, drops, sheets or plates unmanufactured; gold and silver sweepings; British and Canadian coin and foreign gold coin; materials for use only in the construction of ships; anthracite and bituminous coal and coal dust, lignite, briquettes made from anthracite or bituminous coal or lignite, coke, charcoal, peat, wood for fuel purposes; electricity; calcium carbide; gas manufactured from coal, calcium carbide or oil for illuminating or heating purposes; fibre for use only in manufacture of binder twine; ships licensed to engage in the Canadian coasting trade; artificial limbs and parts thereof; donations of clothing and books for charitable purposes; settlers' effects; articles enumerated in Schedule C of the West India Agreement or articles purchased for use of the Dominion Government or any of the departments thereof or by or for the Senate or House of Commons; *"and the Governor in Council shall have power to add to the foregoing list of articles exempted from the tax on sales such other articles as he may deem it expedient or necessary to exempt from the said tax."*

If Canada has found necessary such numerous exemptions

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and additions, those familiar with the course of legislation of general application will fully appreciate the many difficulties which would confront Congress in the consideration of a general sales tax.

It appears that sober second thought in foreign countries and in this country after the Civil War has led to the abandonment of such proposals whenever possible, and already many of those who, at the beginning of the present agitation in favor of a general sales tax, were prominent advocates of such a tax have, after study of the question, become convinced that its adoption would be unwise.

9. It would be economically unsound as well as socially unjust to shift $2,000,000,000 of taxation from business and personal income taxes to consumption taxes.

A sales or turnover tax of general application has been described by one of its former proponents as a "most unblushing consumption tax." Those who claim that a sales tax would be shifted to the ultimate consumer propose that business and personal income shall be relieved of the payment of $2,000,000,000 of taxes and this entire amount shifted to the consumer. One of the accepted principles of sound as well as just taxation is that it should bear some relation to the ability to pay. A tax at a uniform rate upon all purchases, while falling more heavily upon the largest spenders, would not bear any reasonable relation to ability to pay. The great majority of our population must spend their entire incomes for the absolute necessities required to maintain a decent standard of living. Such a heavy tax on those possessing small incomes would be economically unsound because it would have the inevitable tendency to reduce the standard of living by raising the cost of living, and would consequently bring about a necessary curtailment of purchases, or else would have to be met by increases in their wages or other sources of income.

It has been asserted by the proponents of the tax that the cost of living to the great mass of consumers would be actually reduced, because the tax would be small on each individual article and would be passed on in its exact amount, instead of being loaded as it is said the excess profits tax is loaded.

These assertions will not bear investigation. Regardless of what the tax would amount to on each individual article, it is proposed that it should produce as a total $2,000,000,000, to be

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paid by consumers rather than to be taken from the profits of business and personal income. It can be readily admitted that a low-rate tax at a fixed amount such as is proposed might not, when passed on, be loaded to as great an extent as the uncertain excess profits tax, but the mere fact that it is for a definite fixed amount is hardly sufficient basis for the conclusion that it would not be loaded (when it could be passed on) to as great an extent as the taxes proposed by the Committee. The very facts that the tax would be levied upon all sales, including initial sales of raw materials, and that its advocates estimate there would be an average turnover of about six times before the final sale to the consumer, would make it reasonable to expect some loading as the tax progressed. It is customary business practice to add a percentage to the cost of purchases in determining selling prices. If the cost of purchases is increased by taxes paid on prior sales, business organizations would probably find it necessary to load the tax to cover the cost of the extra investment, greater insurable value of the merchandise, etc., in cases where competition permitted them to do so.

A second assertion that will not bear investigation is that the cumulative effect of a sales tax of 1 per cent at each turnover would not be more than 2½ per cent added to the cost of the finished article. Some statements place this percentage as high as 3¼ per cent. The only basis for this assertion which the Committee has been able to discover is the citation of the cumulative effect of such a tax on the sale of certain articles. All of these illustrations appear to deal only with the added cost of the principal raw material, and ignore entirely the effect of the tax on the other factors entering into the cost of producing or distributing the article. As an illustration, one widely-referred-to example is the application of this tax on the price of bread, which states "this total tax, if passed along, is so small, amounting to less than one-sixth of a cent a loaf, that it could not be added to the price per loaf to the consumer. It would probably be passed on by the miller and be paid by the baker, but would be such an infinitesimal reduction from his profits that he would be almost totally unaffected." The tax to be paid is arrived at by adding together the tax on the wheat when it leaves the farm, the tax when it leaves the miller and the tax on the bread when it leaves the baker.

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Leaving out of consideration any effect the tax might have on the cost of producing the wheat on the farm, or the cost of milling it, it is easy to recognize that a calculation is entirely inaccurate which ignores the entire effect of the tax on every item in the cost of baking except the wheat. The baker's cost would be increased by the tax on the coal for his ovens, the tax on the bricks used for rebuilding his ovens and the tax on every single item purchased for the conduct of his business. Illustrations given of the effect of the tax on various articles of clothing make the same error of ignoring the effect of the tax on any item of cost except of the principal raw material. Statements based on such reasoning are manifestly unreliable. To whatever extent a sales tax could be passed on more readily than taxes on profits or income, it would increase the cost of living to those who do not pay these taxes.

The proposal for a general turnover tax is coupled with a proposal to raise the exemptions from the income taxes. This would afford relief to a considerable deserving class. It would not, however, in any way benefit the great mass of people with incomes less than the present exemptions, who form the great majority and the extent of whose purchasing power regulates the demand for most commodities. It is not believed that when business men fully realize the effect of such a tax they will care to go before the rest of the country with any such proposal. Certainly they could not ask Congress to shift the burden of the taxes which they are now paying to the shoulders of consumers generally, without regard to their ability to pay. The Committee is convinced that business as business is willing to bear its full share of the tax burden, although not the excessive and unjust share which it is now bearing. The Committee recommends that, to the extent that it is necessary to replace the revenue which would be lost by the reduction of corporation and personal income taxes, about 40 per cent should be replaced through an increase in customs duties, supplemented by additional sales taxes, but it cannot sanction the shifting of from $1,000,000,000 to $2,000,000,000 to consumption taxes of this sort.[1]

[1] The following extract from the Report of the Secretary of the Treasury, which has just been made public since the final meeting of the Committee, confirms the conclusions already reached by the Committee: "Further consideration of the subject has convinced me that a general sales or turnover tax is altogether inexpedient. It would apply not only to the absolute necessities of life—the food and clothing of the very poor—but it would similarly raise the prices of the materials and equipment used in agriculture and manufactures. It would confer, in effect, a

10. While the Committee has not allowed political expediency to influence it in reaching its conclusions, the political opposition to the sales tax must be given serious consideration.

The Committee has been reliably informed that even though initial sales of farm products were exempted, there would be determined opposition on the part of agricultural interests and perhaps also on the part of labor interests to any form of general sales tax. The Committee would be hopeful that attacks upon sound registration could be overcome by education and discussion, but it feels that the sales tax is too vulnerable to justify attack and that its details, especially the question of exemptions, would present too great difficulties for such a hope in this instance to be realized. In view of the pressing need for immediate remedial legislation, it is desirable that those who have been advocating the sales tax should give this matter most careful reconsideration in order that they may unite in supporting a program of a kind which the Committee is convinced holds more promise of practical realization.

The advocates of the sales tax claim for it all the advantages arising from the repeal of the excess profits tax and the reduction of surtaxes on personal income. The repeal of the excess profits tax and a reduction of the surtaxes are recommended by the Committee. Such claims, therefore, have nothing to do with the question at issue, which is whether the methods of raising revenue recommended by the Committee are fairer, safer and less objectionable than a general turnover tax would be.

Compare the uncertainty as to yield and effect, the inequity as between different forms of business and the added burden to the poorer classes of our population, all inherent in the pro-

substantial bounty upon large corporate combinations and place at corresponding disadvantage the smaller or dissociated industries which carry on separately the business operations that in many combinations and trusts are united under one ownership. The group of independent producers would pay several taxes, the combination only one tax. Finally, it would add a heavy administrative load to the Bureau of Internal Revenue which—burdened as it is with the responsibility of enforcing the child-labor tax law, the national prohibition act, the narcotic-drug law, the adulterated butter and mixed flour tax laws—is already near the limit of its capacity. Simplification of the tax law and restriction rather than extension of its scope are as important from the standpoint of successful administration as from that of the taxpayers' interests. Consumption taxes, if used at all, should be laid upon other than absolute necessaries and restricted to a few articles of widespread use, so that the administration of the tax may be concentrated and made relatively simple."—Annual Report of the Secretary of the Treasury for the fiscal year ending June 30, 1920, p. 28.

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posal for a general turnover tax, with the recommendations of the Committee to raise the revenue by increase in the established corporation income tax, the documentary stamp tax, customs duties, and, if necessary, an excise tax levied at some one point on the sale of a specified list of commodities, which while not absolute necessities, yet are in such strong, constant demand, that the tax would not so seriously affect the sale, as in the case of many commodities which would be included in a general sales tax.

These are all taxes in the collection of which the Bureau of Internal Revenue has an experienced organization. No new form of tax is suggested, and, at the most, only a very few new objects of taxation. The increased revenue would be derived almost entirely from increasing taxes already in force, the effect of which increases can be forecast with considerable accuracy. A sales tax is a departure, the results of which or the revenue to be derived from which none can foresee. It is safer to increase the taxes which produce the least harmful effects than to venture into new and dubious fields of taxation at this critical period. It would be better for business men to unite on a praticable, conservative program for changes in our revenue laws which have a fair chance of accomplishment than to seek for a panacea which is uncertain, unjust and unattainable.

Tax on Retail Sales

The objections to a sales tax at each turnover cannot be met by substituting a general tax on the sale of goods, wares and merchandise at some one point, such, for instance, as upon a final or retail sale for consumption and use.

The contentions of organizations of retailers that such a tax in many cases could not be shifted, and that it would necessarily have to be so large (estimates being not less than 3 per cent) that it would put many of them out of business, are well founded. It is customary for retailers in many industries to turn their stocks from five to ten times a year. The cumulative effect of such a tax would exhaust the net income in any case in which it could not be shifted, and there are many items on which a tax of 3 per cent could not be added to the price. To meet this objection the proponents of the tax assert that the retailer can equalize such cases by adding 3 per cent to his cost of doing business and distributing the tax over the articles which will bear it, just as he distributes any other item of cost.

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The retailers on the other hand maintain that this cannot be done and that if a sales tax is to be levied it should be levied on manufacturers and wholesalers as well as upon them.

A greater difficulty, however, is the determination of when a sale is a sale for consumption or for use. Sugar sold to a householder is probably for final consumption, but sugar sold to a candy manufacturer is part of his raw material. An automobile tire sold to an owner is for final use, but it could not properly be so considered when sold to an automobile manufacturer, in which case its full cost would again be taxed upon the sale of the completed car. Coal sold to a householder is probably for final consumption, but where would the line be drawn in case it is sold:

1. To a gas company for making gas?
2. To a steel company for making its own gas fuel?
3. To a power plant for generating power for sale?
4. To an electric railway?
5. To a manufacturer for making his own power?

If these are considered cases of final consumption or use, this tax becomes practically a turnover tax with all the added objections and inequities which would very possibly arise from its more or less hit-or-miss application to many but not to all turnovers. If they are not so considered, then an elaborate system must be devised to establish the use to which the coal is put in order to secure exemption from the tax. The number of commodities with respect to which a similar situation would arise is inexhaustible, and their very multiplicity presents a difficulty which is practically decisive. Although such a tax levied on all sales would be impractical, there are many commodities on which a sales tax could be levied at some one point in their course from the raw material to the consumer. The Committee recommends the imposition of additional customs duties and sales taxes on commodities which, while not absolute necessities, are of such widespread and general use, so well-established in their distribution, and the demand for which is so constant, that none of these qualities would be adversely affected by the imposition of the tax. The Committee feels it is better to select such commodities intelligently than to levy a general tax without knowledge or investigation of the effect or the practicability of collecting such a tax.

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WHY NOT A SALES TAX?[1]

Ever since man has been living in communities with some form of government, taxation has been a live subject of discussion. The World War with its unprecedented expenditure of life and treasure brought, and has left with us, so many problems of an apparently almost insoluble character or of such stupendous size that it is not surprising to find our tax situation in this country offering difficulties which seem almost impossible of satisfactory solution. Heroic measures were resorted to during the war to raise the enormous amounts of revenue which were indispensable to carry on the tremendous struggle.

When it is realized that immediately prior to the armistice the United States was expending as much every sixty days as the North spent during the whole four years of the Civil War, that in an hour's artillery fire in France more ammunition, by far, would be fired than was used by both sides in the entire three days' battle at Gettysburg, and that all these things have to be paid for in some way or other, some slight conception is gained of the staggering financial problems which the war created. Never before has a war been, to so large an extent, a matter of organization and of industry and support at home. The tremendous expenditures which were thus occasioned could be financed in only three ways:

1. Loans.
2. Issue of paper money.
3. Levy of taxes.

A number of reasons would readily be given why so considerable a part of the expenditure was financed by levying taxes of unexampled severity in both Great Britain and the United States. The excess profits tax, for which we were indebted to the ingenuity and resourcefulness of the British, was imposed from mixed motives. While on the one hand it was the backbone of war taxes, and in fact was indispensable to the carrying on of the war, it was imposed perhaps just as much in the first instance to satisfy British labor, which British statesmen feared would not continue to support the war if capital appeared to be unduly profiting thereby. With all the defects of the war and excess profits taxes, and those who

[1] By Walter A. Staub. Administration. 1:491-503. April, 1921.

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advocated them appear to concede the presence of many defects about as readily as those who may have unwillingly accepted the taxes, it was fortunate for the Anglo-Saxon nations that so considerable a part of our war expenditure was defrayed from taxes instead of through still more loans or by a resort to an inflated currency.

The relatively strong financial position of the United States and Great Britain today is due in no small measure to the courageous manner in which so considerable a portion of the current income of the people in each country was applied to the payment of war expenditures instead of deferring the evil day of settlement as long as possible through still greater loans and the unlimited issue of paper currency. The financial position of Germany today would be much stronger, if, instead of relying on the indemnity she expected to collect from the defeated Allies and levying taxes to only a moderate extent, she had laid taxes on war profits in the same measure that was done in Great Britain and America. France, too, failed to levy taxes to the same courageous extent that Britain did, though an extenuating circumstance, not to be overlooked, is that the defaulting by Russia of the interest on her bonds, which were so largely held in France, made tremendous inroads on the income of France and greatly impaired the tax-paying ability of her citizens.

Sad to say, many of the burdens imposed by the war will be with us for years and years to come. The signing of the armistice did not bring to an end the need for further large expenditures of money by the various governments. In our own country the war debt created in less than two years' time now calls for an annual expenditure of interest (without allowing for any offset of interest to be collected from loans to our allies, the payment of which cannot safely be relied upon for at least some time to come) equalling what before the war was considered a huge national budget, that is, approximately $1,000,000,000. The $1,000,000,000 pre-war budget included not only the expenditures of non-revenue producing departments of the national government, but also for the post-office and for much "pork" for all kinds of river and harbor improvements, post-office buildings, and similar public works which congressmen love to secure for their home districts. Not only do we have the additional annual burden of war loan interest on top of the pre-war government

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expenditures, but the current expenditures of the government for non-war purposes have not yet been reduced to a pre-war basis. Also, the "mopping up" expenditures following the war, i.e., settlement for canceled contracts and war claims of all kinds, shipping board losses, etc., will probably continue in considerable amounts for some time to come.

The large national expenditures, including a floating debt which is hanging over our heads and which there seems to be a fear of attempting to fund, call for national revenues for the next several years, so the Secretary of the Treasury calculates for us, of approximately $4,000,000,000 per annum. This is about four times the largest pre-war budget, which as already stated had included such expenditures as those for the post-office which brought in a considerable revenue. The $3,000,000,000 more which we shall need to pay out for each of the next few years, in addition to the pre-war budget, will bring in but little income to offset expenditures. The only offset will be the reduction in interest charges due to paying off the floating debt and such part of the Victory notes as may be redeemed and not funded at maturity in 1923.

When one looks at this tremendous amount to be raised and thinks of the heavy taxes that, no matter what their form, must be laid, one yearns for those days when the corporation income tax was 1 per cent (we smile now when we think of how oppressive a tax of $50,000 on a $5,000,000 corporate income seemed in 1909) or for those modest and retiring surtax rates which under the 1913 law went only as high as 6 per cent on individual incomes of $500,000 and over.

It did not take long to realize that, even though the war was over, heavy tax burdens would continue for a long time. Also, when the attack on the excess profits tax as being un-American, undemocratic, and tending to discourage business initiative grew strong. It was seen that before this tax could be abandoned it would be necessary for Congress to see some other way in sight by which the revenue necessary could be secured. Consequently, those who were eager to eliminate the excess profits tax, and at least to reduce very substantially the surtaxes on individual incomes, soon realized that such proposals would be considered only academic and would receive but little serious attention unless they were accompanied by practical suggestions for other means of raising the needed revenue.

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Of all the proposals which have thus far been made for replacing the revenue which will be lost by abolishing the excess profits tax and reducing the higher surtaxes, or by such sources of revenue drying up, the proposal of a sales tax has been pushed with the greatest vigor and supported by more energetic and extensive propaganda than any other.

The sales tax as pictured by those convinced of its practicability is most alluring. In effect we are told, on the one hand, that it is so simple that no one will have the slightest difficulty in making up his monthly sales tax return in a few odd moments one evening a month, that the tax will produce billions of national revenue, and that (Oh! joyful thought!) every penny of the tax will be passed on to the ultimate consumer, that elusive character who seems to be in a class with the missing link. On the other hand, we are led to believe that, even though the ultimate consumer is handed for payment as a part of his grocery, butcher, and haberdashery bills, such a small amount of tax thereon as anywhere from $1,000,000,000 to $6,000,000,000, the tax will spread out so thinly over our large population that nobody will feel it and that the difference in the family exchequer will not be any more noticeable than if a few more dimes and quarters had been spent for amusement this week than last.

All jesting aside, if it were possible to institute a sales tax which would accomplish only 50 per cent of what is claimed for it, it would be a wonderful source of revenue. Unfortunately, the very ease with which it is claimed such a tax could be levied, would be a temptation, when the insistent need for large revenues has somewhat abated, for the raising of public funds in unnecessary amounts. Such funds would be in danger of being squandered for non-essential public purposes as is so often the case when a government has more liquid funds than it really needs.

The purpose of this article is to examine briefly the claims which have been made for the sales tax, and to discuss them in the light of those difficulties which it has been pointed out would be likely to be encountered in attempting to institute and administer such a tax.

Before proceeding to the consideration of the matter in detail it is to be pointed out that several different kinds of sales taxes have been advocated. There is the general turnover tax which

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proposes to levy a tax of say, not over 1 per cent, on absolutely all sales or turnovers including not only commodities or merchandise in every form but also capital transactions, such as sales of real estate and securities, services such as those rendered by lawyers, architects, and other professional men, and rents and interest. In sharp contrast to the general turnover tax is the retail sales tax which proposes to levy a tax of say 1 per cent (presumably, however, the rate would have to be higher if anything like the same amount of income is to be secured as under the general turnover tax) on those sales which are made to the ultimate consumer, in other words retail sales.

Between these two plans is still another which would lay a tax on all sales excepting those which represent turnovers of capital or which are service earnings rather than sales of merchandise.

The principal arguments urged in support of the plan for some one of the three forms of sales tax mentioned above have already been alluded to. They are briefly:

That the tax would be extremely simple of calculation and of collection.

That the tax would not be a burden to business as, being at a uniform rate on all sales, it would be passed on to the purchaser, either as a specific item or as a part of the sales price.

That the tax would be so small that it would not be felt by those who eventually have to pay it, namely, the ultimate consumer.

Other arguments for the enactment of a sales tax are really only variations of these three.

Let us now hear from those who have wondered why such a perfect tax has not long since been discovered and adopted by all progressive nations and who feel certain that there are fallacies in the arguments which have made this tax so alluring.

For purposes of discussion, simplicity of calculation may for the moment be conceded for the general turnover tax. The moment, however, we depart from a tax which is imposed upon absolutely every turnover of every description, difficulties of calculation involving construction and interpretation of the law will surely arise just as much as, and perhaps even more than, has been the case under our excess profits tax acts and even under the relatively simple income tax laws. The difficulties

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involved in determining, in the case of the retail sales tax, which sales are to ultimate consumers and which are to others and, therefore, not subject to tax, can easily be imagined. The opportunity for evasion would in all probability be greater under a retail sales tax than is the case at present with reference to income taxes. In principle it is a simple thing to record sales. Yet it is an astonishing fact that many business concerns and particularly the individual retail merchant have very defective sales records. Those who have struggled with the analysis of an old-fashioned merchandise account in which all possible varieties of transaction, debit and credit, have been intermingled, may have some conception of the difficulties of calculation and administration where each sale is to be allocated to either one of two groups: one, the goats, those to the ultimate consumer on which the tax is to be paid, and the other the sheep, those which are not responsible for imposing a burden on either buyer or seller in the way of sales tax.

What might be termed the merchandise turnover tax, that is the tax on all turnovers on merchandise, excluding capital transactions and charges for services, would also develop difficulties of calculation and administration. Just where to draw the line between the sales subject to the tax and those not subject thereto because of being one of the excluded classes would develop perhaps as many perplexities as have resulted from the attempt to make invested capital a base for profits taxes. Where would the line be drawn? For instance, what would be done about exchanges of property or exchanges of merchandise? How about sales of machinery or other articles which may represent merchandise or income-producing sales to the seller but which represent a capital investment by the purchaser?

Even the general turnover tax, with all its apparent simplicity, would offer difficulties not to be lightly brushed aside. There would almost certainly be exemptions created sooner or later for certain classes of sales or turnovers and, with any exceptions whatever, difficulties of classification of sales would at once arise.

Difficulties of administration would arise through the incentive to arrange transfers of property and merchandise in such a way that actual sales would be avoided or deferred. For instance, leasing and consignment arrangements would probably

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be widely resorted to. Such arrangements in place of the outright sale of goods to distributors would not be a wholesome development in the business world. Also, it would tend to increase unnecessarily the difficulties of those with only a moderate capital, sufficient for their business under present methods of distribution but inadequate for carrying goods on a consignment or lease basis until disposed of by the distributor to the retailer. Competition would tend to drive businesses generally into such arrangements to a considerable extent.

Assistant Secretary of the Treasury Leffingwell is quoted as having said that a turnover tax would in five years revolutionize present methods of doing business, because means of getting around the intermediate turnover tax would be devised and put into effect. Changes in business methods should, however, come as a result of economic improvements and increased efficiency, not as the result of a desire to avoid a tax imposed on business and tending to hamper it.

The questions which have been raised, as to whether in fact the calculation and collection of the tax would prove to be as simple as proponents of the sales tax believe, are not as serious as those which relate to the burden on business or the possible unfair distribution of the tax among the people who will eventually pay it.

Students of taxation and those who have had wide opportunity for observation of the working of the taxes in practice have challenged very sharply the claims that the imposition of a uniform rate of tax would be absolutely fair as between one industry and another, and that in any event the tax could not be burdensome to business as it would be shifted to the consumer and none of it would thus be borne by business as such. The first proposition involves the second because, if the tax would invariably be shifted, it would make but little ultimate difference to business how much the tax was, excepting for the temporary inconvenience perhaps, of having to pay over the tax from month to month while part of it was still in the form of accounts receivable yet to be collected from customers.

That the shifting of the tax would not be the simple matter which has been assumed by its proponents seems to be quite evident upon consideration of a few every-day facts. It would be natural to assume that every expense incurred by a manufacturing or mercantile business would in due course be shifted

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to the purchasers of its products or merchandise. Surely no manufacturer or merchant wants to absorb any expenses which are incurred in the manufacture or sale of goods and yet in practice this is exactly what does happen to many concerns.

Figures recently published by the Commissioner of Internal Revenue show that during 1918, a year of wonderful business prosperity, more than one-third of the corporations in the United States made no profits whatever. Those corporations which did report profits showed great variations in the amount realized. Not only was there variation between industries, but individual corporations in the same industry showed a great difference in profits realized. If in a sellers' market, when prosperity was enjoyed by many concerns which for years before the war had not earned a fair return on the capital invested in them and when corporations were supposed to have passed on the excess profits tax to their customers time and time again, over one-third of the corporations of the country earned no profit at all, is it reasonable to suppose that under competitive conditions (to which we are rapidly returning, if in fact we have not already arrived), every business concern will invariably succeed in passing on the sales tax to its customers, and this neither more nor less than the amount of the tax paid by it to the government?

How would public utilities whose rates are regulated by law pass on the tax? Or even if a street railway, which charges anywhere from 5 to 10c. per ride, is authorized to pass on the tax, how is it to do so in practice? On a 5c. fare the tax would be only 5/100 of a cent; if a full cent additional is collected, the tax is being passed on twenty fold, whereas if it is not passed on because of its trifling amount in the case of the individual fare, it would aggregate a large amount in the total gross earnings and impose a heavy charge on the net profits.

In an editorial in the New York Times of February 5, 1921 entitled, "The Profits Tax Must Go," appeared the following statement:

> A flagrant instance of the vicious character of the tax imposed upon corporations in this country is disclosed in the annual statement of Montgomery, Ward & Co. of Chicago. With net sales in 1920 amounting to $101,745,270, the company shows losses of $7,855,278, including depreciation. Yet during this year of loss the Federal Government took from the company $860,326 in taxes upon business of the year 1919.

The writer of the editorial apparently overlooked the fact that with 1 per cent sales tax in force the company would not have paid $860,326 of profits and income taxes upon the profitable

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business of the preceding year, but a $1,017,452 tax on the sales of the current year. Also, he overlooked the fact that had the year 1919 not been a profitable one for the company, it would not have had to pay excess profits and income tax, whereas the sales tax, had one been in force, would have had to be paid regardless of whether the year's business resulted in a gain or in a loss.

If the reply were made that had the sales tax been in force it would have been passed on to the company's customers, the question may well be asked, why was not the loss of $7,855,278 passed on? The same circumstances which caused this company to lose money on its 1920 business would in all probability have caused it to forego, whether it wanted to or not, the passing on of the sales tax to its customers.

If the sales tax cannot be invariably shifted in its entirety it becomes a tax on gross earnings and would in very many businesses be far more burdensome than the excess profits tax has been. Many businesses, particularly in lines handling staple commodities such as meats, groceries, dry-goods, hardware, and the like, are conducted on very small margins of profits. The published reports of Swift and Company, the meat packers, show that during the ten years from 1911 to 1920 the highest net profit per annum on sales was 3.96 per cent in 1917 and the lowest .44 per cent (less than 1 per cent) in 1920. Before the war there were many mercantile businesses which were thought to be doing very well indeed if they cleared net from 2 to 3 per cent on their gross sales for the year. A uniform rate of tax for all businesses regardless of the fact that some are conducted on a margin as low as that mentioned, while in some other lines, such as special manufacturing or the like, the rate of net profit may even in normal times be from 10 to 15 per cent of the sales, shows how unfair a uniform rate of tax would be.

The continued emphasis on the low rate of a sales tax is likely to mislead one who does not give the matter very thorough consideration. It must continually be borne in mind that the tax is on gross business and not on net profits. Hence, the tax while expressed in a small rate may nevertheless amount to a large percentage of the net profits, especially in the case of those businesses having a large turnover with a small margin of profit. Rain descends in the form of drops of water, each

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drop small in itself, but when there are enough of them a cloudburst is the result.

Aside from the injustice of imposing a uniform rate of sales tax on all businesses, regardless of the fact that some industries yield a much larger return per dollar of turnover than others, another discriminatory result appears because of the greater number of processes or operations performed by one business as compared with another. This question was thoroughly considered by the Tax Committee of the National Industrial Conference Board and was made the subject of the following illuminating comment in the Committee's report.[1]

If a 1 per cent turnover tax were imposed upon each step in the cotton industry it would fall upon the following sales:

Raw cotton to ginning mill.

Ginner to spinner.

Spinner to mercerizer.

Mercerizer to dyer.

Dyer to weaver.

Weaver to finisher.

Finished cloth through agent to wholesaler.

Wholesaler to retailer.

There are many textile plants which buy the cotton from the ginning mill and sell the finished cloth through their own selling organization to the wholesaler and retailer, thereby eliminating one-half of these steps. It is claimed that the advantage which the large mill carrying on several consecutive steps would have over its smaller competitors, is small compared to the advantage which it now has through the profits made from each process. Such a contention ignores the fact that profit should be measured as a percentage on the business investment, and that a business concentrating on one process and investing all its money in that one process may earn as large a return on its capital as the competitor who spreads his capital over several processes, and should, to be equally successful, earn as much profit on each process as competitors carrying on separate processes. Single-process businesses are therefore able to compete successfully with those which carry on multiple processes. A turnover tax would discriminate against them. Regardless of whether the advantage which such a tax would give to the self-contained operator is large or small, it is questionable whether the

[1] Special Report No. 18. December, 1920.

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Government should levy a tax that would have even a tendency to drive smaller enterprises out of business.

A second illustration applies to the shoe industry. In cases where each operation is carried on separately, a turnover tax would be levied on the sales of:

Hides to tanner.

Tanner to leather merchant.

Leather merchant to shoe manufacturer.

Shoe manufacturer to jobber.

Jobber to retailer.

Retailer to consumer.

At least one large shoe manufacturer tans his own hides and sells the finished shoes through his own chain of retail stores to the consumer. It has been estimated by one of the prominent advocates of the sales tax that in this case the cumulative tax saved by the large shoe manufacturer would be approximately 3 per cent. This is undoubtedly an underestimate, but the Committee is informed that 3 per cent on their gross sales is as much as the average net profits of some leading shoe manufacturers in pre-war times, as shown by the published reports of their earnings.

A third illustration is offered by following the course of any common tool, such as a shovel, pick or axe, through the two extremes of the greatest compared to the least number of turnovers. In the one case the tax would be paid on the sale of:

Iron ore, limestone and coke to make pig iron.

Pig iron and coke to make steel ingots or billets.

Steel ingots or billets sold to rolling mill to make bar steel.

Bar steel sold to tool manufacturer.

Tool sold to wholesale dealer (the customary practice).

Tool sold to retailer.

Tool sold to consumer.

If a certain well known corporation which combines all the steps from ore to bar steel furnished the steel to the tool manufacturer and he sold it to one of the large mail-order houses, there would be only the tax on the sale of the bar steel, on the sale of the mail-order house, and on the sale to the consumer.

It may be claimed that the first three taxes are so small a proportion of the cost of the tool that their elimination would make little difference. It must be borne in mind, however, that this same elimination would occur in many of the other items of cost in the manufacture of the tool. It would apply to the

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manufacturer of the handle. One manufacturer might make the handle from his own timber, cut and shipped by his own men, and another might have to buy handles made from timber bought from timber owners, cut and shipped by handle blank makers, and turned into handles by a handle maker, thereby paying three taxes. It would apply to coal for power, which in one case might be shipped directly from the mine and in another case pass from the mine owner to the commission merchant, to the coal dealer, to the manufacturer. It would apply to the belting to drive the machinery, to the machinery itself when purchased, and to the countless supplies used to operate the factory. The elimination of any of the processes of distribution would, of course, eliminate the tax on substantially the total cost of the tool. Average records in the hardware business show that the wholesaler who distributes such tools does not in normal times realize net profits of more than about 2½ per cent of his gross sales, so that the elimination of this one tax through sales directly to a retailer would be equivalent to about 40 per cent of the net income derived from such sales by a wholesaler. How could such a tax be shifted in competition with those who do not pay the tax? Supposing that a general sales tax would be figured by every business as an item of cost, can it be assumed that certain businesses would be able to shift a tax which their competitors did not have to pay?

Even if it were generally conceded that the tax can be passed on to the consumer in its entirety, that it will, therefore, not be burdensome to business, and that the rate, even though uniform for all lines of businesses, is not material, the serious question still remains whether the tax, when it is eventually paid by the consumer, results in a just distribution of the country's tax burden. This is the viewpoint from which perhaps the most serious attack has been made on any form of general sales tax. One of the fundamentals of wise taxation which has become increasingly recognized from the days of Adam Smith down is that a tax should be levied according to ability to pay. So long as in the apportionment of the country's produce—the result of productive effort—we make a discriminating distribution, i.e., a larger portion to him who renders the larger service, or in other words, reward according to ability to earn or serve, we must expect to apportion the fiscal burdens of the country in like manner, i.e., according to ability to pay.

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A tax on consumption does not fall according to ability to pay but in reality is laid according to one's needs. The mere fact that within certain limits one may increase or decrease his consumption does not really alter the situation. The great majority of the population of any country are people who with their best efforts earn but a modest income and are bound by circumstances to disburse the major portion of it as fast as earned for necessary living expenses. To be sure, during the war certain classes of workers enjoyed most unusual prosperity and spent their earnings, many of them, in an unusually extravagant manner. Opportunity for repeating the performance has disappeared for most of them and present business conditions give no hint of a recurrence in the near future.

Assuming that wages have returned, as they are now in the process of doing, to a normal basis and that, saying nothing of workers who are out of employment, the worker is earning but little more than sufficient to maintain himself and his family, what is the effect of levying a sales tax which would produce say $2,000,000,000 annually? There are about one hundred million people, including men, women, and children, in the United States, and this amount of tax would mean about $20 per capita. If the tax is to fall on consumption, that is, on needs rather than on ability to pay as indicated by income, why not save all the trouble of passing the tax through the myriad channels of hundreds of thousands of business enterprises and levy it directly on every man, woman and child in the United States? In other words, levy a poll tax of $20 per capita. This would mean that the workman having a family consisting of wife and three children (the average family in the United States is usually considered to consist of five persons, though the number averages probably higher among the poorer classes and lower among the well-to-do) would have to pay $100 poll taxes for the family.

When it is remembered that before the war the average annual income of a worker in the United States was not over $700—it was usually stated at a somewhat lower figure—and that even with the high cost of living during recent years it did not rise to more than $1,300, if that much, the hopelessness, not to mention the injustice, of attempting to collect such a tax from the working class is obvious. Of course, the consumption expenditures of the well-to-do average somewhat more

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per capita than is the case among the wage-earners, but it is not likely that they would average enough higher to reduce the per capita out of a $2,000,000,000 sales tax to lower than $17 or $18 for the working classes. It is not to be overlooked that the living expenses of well-to-do people include items which would not be subject to the sales tax, such as wages of servants, while presumably but little which the wage-earner purchases would escape the tax.

E. R. A. Seligman, who is perhaps the greatest authority on taxation in this country today, makes the following significant comment on this subject:

> The proposition now is to take off one of those three chief categories—the tax on excess profits—and remove the burden from profits on wealth or income, and put it on the other or consumption side. This would, in my opinion, unduly shift the balance and bring us too near the position formerly occupied by all the aristocracies of old, and still reflected in some of the European countries. . . Why is it that England and America show their democracy, their real democracy, so much more than countries in the difficult position of Italy, or France, or Germany? There you will find throughout the war, and even now, the great mass of taxes imposed upon the consumption of the common man; whereas in England and in the United States during the Great War, as over against our experiences in the Civil War, the great majority of taxes are raised from wealth; that is, from those who can afford to pay, rather than from the consumption of the necessaries and comforts of life. . . After the United States, the two countries of the world which are making the most progress in fiscal reform are England and Italy—for Italy is doing better than France. When these two countries came to consider this problem they went into the question of a sales tax thoroughly and finally rejected it. On the other hand, the two big countries of the world that have adoped the sales tax, Germany and France, did so only as a last resort, after exhausting every other available source of taxation. . . Germany was forced to this sales tax in the last extremity, and in France the same is true.

A sales tax on the sales of capital would ruin New York City as the financial center of the country. A sales tax on the necessaries of life would evoke a political struggle the like of which we have never seen in this country.

The sales tax represents an attempt to put an undue, an extravagant burden upon the consumer, instead of on the producer or the possessor of wealth. [1]

Professor Seligman's reference to the history of sales taxation directs attention to the statements made by its proponents that the sales tax—presumably of the same general nature as that proposed for adoption in this country—is in successful use in the Philippines, Mexico, Canada, and France. The facts, as far as the writer has been able to ascertain them, appear to be about as follows:

[1] Extracts from statements to the Tax Committee of the National Industrial Conference Board.

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PHILIPPINE ISLANDS. A former collector of internal revenue in the islands who lays claim to having drawn the plan for the sales tax in force there, attracted considerable attention by an address on the subject recently delivered before the Chamber of Commerce of the State of New York. He stated that the tax is being successfully administered, is the biggest revenue producing factor in the Islands and that it is satisfactory to taxpayers.

For several reasons, however, the sales tax in the Philippines—even if it be granted that it is all its originator claims for it, though there are not lacking former residents of the Islands who do not concede all that is claimed for it—is of little help in indicating what the experience with a general sales tax in the United States would be. In the first place, there is comparatively little manufacturing in the Philippines; the industries are principally of an agricultural character and the other business is of that mercantile character which is naturally affiliated with agricultural pursuits. In the United States, on the other hand, manufacturing through many operations, starting from the raw materials and progressing to highly refined products, forms an enormous volume of the country's industry. It follows that, under the simple kinds of industry in the Philippines, involving relatively few turnovers between origin or arrival of commodities in the Islands and their final consumption or exportation, pyramiding of the sales tax might not be great. In the United States, however, with its highly integrated industry, the number of turnovers between origin of the raw materials to the final consumption or sale to other countries would be so large that the pyramiding or accumulation of sales tax through the various steps of production and distribution would be most serious. Furthermore, the inevitable discrimination against the single-process manufacturer in favor of the multiple-process manufacturer or combination manufacturer-distributor would be a most undesirable economic condition, an irritating element in the business organization of the country and a possible source of political disturbance.

After considering the utter dissimilarity of business conditions in the Philippines from those in the United States, attention is to be directed to the yield of the tax in the Philippines. The annual report of the Collector of the Internal Revenue of the Philippine Islands shows that from revenue

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collections aggregating during the calendar year 1919 approximately $27,000,000 about $7,000,000 came from merchants, manufacturers, common carriers, etc., as "license, business, and occupation taxes." This appears to be the caption under which the sales tax collections are included, though it is not clear that the $7,000,000 was produced entirely by the sales tax.

Inasmuch as the population of the Philippines is approximately eight million, the sales tax collections, the rate being 1 per cent, were less than $1 per capita of population. At the same rate of collection per capita the annual yield in the United States would be less than $100,000,000, a comparatively negligible figure when considering the high sums of revenue we must raise for some years to come. On the other hand, advocates of the adoption of a sales tax in this country estimate the collections anywhere from $1,000,000,000 to $6,000,000,000. The lowest of these would amount to a per capita average of $10, more than ten times that realized in the Philippines, and the highest amount would average $50 per capita. A little study of these figures makes it obvious that it would be absolutely unsafe to base any experiments in the United States on the experience in the Philippines.

MEXICO. Is it not rather humiliating to have the taxing system of Mexico held up to us as a model to be followed by the United States? The finances of Mexico do not give evidence of having been either well-planned or well-handled and while we all recognize that the continuous disturbances have in a measure been responsible therefore, it is to be borne in mind that none of the Latin countries of modern times has been so successful in dealing with national finances as to be a model to the Anglo-Saxon nations.

Incidentally, H. B. Fernald makes the positive statement[1]—that "It (sales tax) can be eliminated; it can be gotten around. The experience in Mexico has shown that conclusively, and therefore it is a tax which will be paid by the small man, while the large man, who is able to change his business organization can avoid it."

CANADA. The sales tax in Canada, whatever it may originally have been intended to be is not at all the kind of general sales tax which has been ardently advocated for imposition in the United States. Many foodstuffs, coal and other necessities, are

[1] Congressional Record. 60:2474.

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exempt from the tax, the law grants power to the Governor in Council to add to the exemption list, the tax is imposed on manufacturers, wholesalers, and jobbers (not on retailers), and while nominally at a uniform rate is in fact in addition to numerous excise or luxury taxes at varying rates previously imposed on many of the same commodities.

Also, it is not to be overlooked that the Canadian tax is of very recent origin and has not been in effect long enough to serve as a safe basis for conclusions as to its efficacy and the wisdom of this form of taxation.

FRANCE. The sales tax in France is likewise of such recent enactment that conclusions respecting it cannot have a very satisfactory basis. From the standpoint of fiscal results, at least, it has been very disappointing. The August and September, 1920, collections were much less than one-half the amount estimated for the budget, which was ascribed in part to the newness of the tax. A recent issue of the Revue de Legislation Financiere, contains a statement showing that later collections, those of December, 1920, were still very unsatisfactory, being only about 50 per cent of the budget estimate. Reports from France, also indicate that there is great dissatisfaction with the tax, not only on the part of the consuming public, but by the merchants.

In concluding this discussion of the sales tax the writer would like to quote the following comment by Arthur A. Ballantine, formerly Solicitor of Internal Revenue, on the fallacies of the sales tax:

"I believe that this idea of a sales tax, a tax collected everywhere, falling on no one, is a will-o'the-wisp which has floated over this field of taxation and which is in danger of luring business men who approach Congress in an effort to get really beneficial changes into futile action instead of constructive action.

"I believe that this committee, by the very careful and exhaustive consideration which it has given to the advocates of this plan and its careful thought as to conclusions, has done much to dissipate this myth and to direct the efforts of business men into practical channels instead of down a pathway which leads to futility."[1]

[1] Remarks at a meeting of the Tax Committee of the National Industrial Conference Board; quoted in Congressional Record. 60:2473.

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SALES TAX—AN INIQUITOUS PROPOSAL[1]

It is expected on every hand that the present session of Congress will in some manner revise the system by which federal revenues are derived. Whether the congressional rearrangement of taxation will be wise or unwise remains to be seen, but if congressional action in some other directions is to be accepted as a guide, it will require much effort to keep new taxation legislation from running wild.

Perhaps the most iniquitous proposal that has been considered by congressmen in the field of taxation is the sales tax as a substitute for the existing excess profits tax. It would be difficult to devise a system of taxation more inequitable and more unjust than a sales tax. It would be far better to leave the system of taxation as it is even with all of the inequalities of the income and excess profits taxes than to substitute these with the sales tax.

Under the sales tax as proposed, a tax would be levied on practically every commodity of general use and every turnover. That is to say, that every pound of sugar for example would be subject to a tax with every transaction from plantation to consumer. Illustrating the consequences of the sales tax, Congressman James E. Frear of Wisconsin, on January 31, 1921, said in a speech in the House:

> There are practically nine turn-overs in the case of cotton and woolen goods; eight turn-overs in the case of leather goods, and seven or eight in the case of steel, that is, from the original ore up to the time of the finished article; what applies to these articles applies with equal force to almost everything we use. In other words, this proposed tax of 1 cent on each turn-over has to be applied from five, six and seven to nine times. You will find that in many cases where the present tax on luxuries is imposed they have raised the price of the goods sometimes 400 per cent during the different turn-overs.

Congressman Frear has not in any sense over-estimated the inequity of the sales tax. While all taxes rest more heavily upon the poor than upon the rich, the sales tax would be more unjust in this direction than any others. It is a matter of common knowledge that the purchases of the poor usually are made in small quantities and consequently at the highest prices. For that reason alone, the poor would pay on any given quantity or commodity a tax several times as large as the tax paid by

[1] By Samuel Gompers. American Federationist. 28:495-7. June, 1921.

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the well-to-do, whose purchases would be smaller in number, but larger in bulk.

The sales tax has no scientific justification and no utilitarian justification. It is nothing more than a hodge podge proposal conceived much as most of our tariff legislation has been conceived. Unless the object of Congress is to place upon the people the heaviest and most awkward burden possible, and to leave the question of revenue further from solution than it is at present, the idea of the sales tax should be abandoned immediately.

There is room for improvement in both the income and the excess profits tax and it will be well for Congress to give some inheritance taxation. It is possible to so rearrange the income tax as to provide a more equitable distribution of the burden imposed and to take from the tax some of the inexcusable awkwardness that now attends its imposition and its collection. There has been, and there is, much agitation for the repeal of the income tax, or at least for higher exemption figures. If it is possible to raise the limit of exemption or to impose a lighter rate of taxation upon the lower incomes, that should be done, but the tax itself is right in principle and should be retained. The same is to be said in the case of the excess profits tax. Many large corporations and representatives of vested interests are endeavoring to secure the repeal of the excess profits tax because of the "burden" it is claimed to impose upon the corporations whose profits are large. They desire, of course, to escape as much taxation as possible, but while their efforts are understandable they should not be permitted to succeed. Experience should, by this time, have provided a guide to a proper rectification of the excess profits tax so that the burden may be more properly distributed and the total revenue increased.

What has happened to the excess profits tax as it stands is that corporations have devised every possible method to escape payment by means of so spending their money as to dissipate their taxable excess. To do this corporations have plunged into great advertising campaigns far in excess of their needs, with the result that the amount of taxable excess has in many cases been reduced to an absolute minimum. Other corporations have entered into the construction of buildings and like projects purely in order to expend the surplus and avoid the payment

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of tax. While this is beneficial from the standpoint of stimulating business and industry, it is detrimental so far as federal revenue is concerned, because it defeats the tax and leaves the government without a revenue anticipated and upon which account has been taken. A moderation of the tax undoubtedly would result both in less hardship and in a greater revenue.

Another method of taxation being considered by members of Congress is the land tax. There is much opposition to a land tax, and doubtless much misunderstanding of it. Perhaps no tax is more equitable than a properly administered land tax. It is doubtful whether the present Congress would agree to a land tax, but if it were possible, neither the wage-workers of the cities nor the farmers of the country should oppose the measure. The chief opponents of the land tax undoubtedly are those who hold large tracts of land for speculative purposes, and those who hold land valuable for its mining resources. The land tax constitutes a penalty upon idle and unused land and should rest comparatively light upon the owners of small properties upon which they make their living.

The principal concern at this time, however, is that the proposal for a sales tax be defeated. Of all forms of taxation either in existence or contemplation, none is more iniquitous and none would in the long run work greater injury to the masses of our people or develop greater resentment among them. If we cannot have a truly scientific program of taxation, let us at least not have the ultimate in chaos.

SUBSTITUTES FOR THE PROFITS TAX[1]

Excess profit appears to the New Republic an eminently proper subject for taxation. It is the income from which the state can take a share with the least hardship to the taxpayer. A profits tax, scientifically levied and efficiently administered, is from this point of view a good tax. Our present tax is imperfect, but one-half the energy that is expended in working for its abolition, if directed toward its amendment, could make an excellent fiscal expedient out of it. But in the field of taxation there is nothing that is absolutely good. One tax is merely better than another as one death is easier than another.

[1] New Republic. 22:304. May 5, 1920.

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We are not asserting dogmatically that the excess profits tax is better than any other that could be substituted for it. We merely do not know of a better tax that will make up the $1,000,000,000 or more that can be got out of the excess profits tax. If any one will convince us that there is another tax equally productive, and fairer and less onerous in its incidence, we shall transfer our loyalty at once.

Two proposals have of late received wide attention and much support among business men. They are for a tax on retail sales and for a tax on gross sales of whatever character. The tax on retail sales appears to us politically impracticable because of the high rate that would be necessary to yield $1,000,000,000 of revenue. It is a generous estimate that the aggregate income of the American people is $75,000,000,000. Deduct from this, as the outside limit of spending power, all sums for reinvestment, all sums paid out for rents, travelling expenses, entertainment, personal service, etc., and the remainder can certainly not exceed $30,000,000,000 or $35,000,000,000. There must be further deduction for evasions, and if petty trade receives any exemption—apparently a political necessity—the volume of taxable sales is not likely to exceed $20,000,000,000 or $25,000,000,000. A 5 or 6 per cent tax, would be necessary to insure a revenue equivalent to the loss that would be entailed by the abolition of the excess profits tax. Certainly the retail dealer would not stand this loss. He would advance prices, in the first instance, and he would hardly content himself with the precise measure of the tax. On large sales he might, but on small ones he would not. How can a tobacconist recoup himself for ½c. tax on a cigar except by raising the price 1c.?

It will be said that the retailers' costs will be lowered since the producers will no longer have to count excess profits taxes in making up their selling prices. Thus there might be an offset to the addition the retailer would have to make to his prices on account of the sales tax. But we have yet to see anything like proof that the businesses paying excess profits tax would lower their prices materially if relieved of the tax. They might do it if they had no other use for the money, but as a fact, they are busting with projects for using the money in the expansion of their business or in new investments. Such uses may be socially desirable, but they are something quite different from lower prices to the consumer. To substitute a retail sales

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tax for the excess profits tax, therefore, seems to involve an unavoidable increase in the cost of living. And that is something for which no shrewd political leader will lightly assume the responsibility.

The gross sales tax presents the advantage of rates that look so low on paper that it seems almost un-American to object to them. The Bache Review, which reflects higher financial opinion in its eager advocacy of this tax, estimates the aggregate turnover of American business at $1,500,000,000,000. That includes many items, such as speculative transactions in securities and produce, which the Bache Review would never think of taxing in the same manner as other sales. Such transactions obviously would not stand much of a tax. But they can hardly exceed $500,000,000,000. The remainder of $1,000,000,000,000 may be halved, for the sake of safety, and yet leave a volume which under a 1 per cent tax would yield $5,000,000,000, almost five times the excess profits yield. What is the difficulty here? It must be plain that the consumer's ultimate spending power can expand into such prodigious turnovers only through the fact that most goods pass through many hands on their way to final use. A 1 per cent tax at each transfer would mean a huge addition to the final price and a great increase in the cost of living. That is not the worst thing about a tax of this kind. Businesses organized to carry the material all the way through to the consumer, like some of our great consolidated industrial concerns, would pay the tax only once. Businesses buying half manufactured goods for further manufacture would pay the tax several times. The tax would thus be a crushing artificial burden on the small concerns. It is hard to conceive of a tax more unsound, economically, socially and politically.

WHERE IS THE TAX BURDEN GOING? [1]

Under cover of a movement for what is termed "tax revision," a nation-wide propaganda is being conducted by various "business" organizations for the purpose of securing the abolition of the surtax on incomes and the excess profits tax. Behind their prattle about "oppressive tax burdens," and the need for greater economy in government, stands out one fact: the merchants,

[1] By Whidden Graham. Nation. 113:315. September 21, 1921.

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manufacturers, bankers, brokers, and corporations want to get rid of taxes that they are now paying, and are willing that the loss in revenue should be made up by a sales tax that will not only add the amount of the tax to the cost of living, but will compel the consumer to pay pyramided taxes and profits. The purpose of this accelerated demand for "tax revision" is therefore clear—to shift taxes from those best able to pay, the small but influential minority, and lay them upon the general public. Now all this agitation is perfectly legitimate. If the financiers and big business men want to get rid of taxes, they have a right to agitate for legislation lifting their burdens. But their propaganda, based on disingenuous misrepresentations and abetted by a large section of the press, should be subjected to rigid inspection by the public it is designed to impress.

The main argument for repeal of the surtax on income is that this tax is one of the chief causes of "poor trade, tight money, diminished enterprise and employment." As it was stated by a prominent advocate of repeal in a speech before the Pittsburgh Traffic Club: "Capital has been driven from the highways of trade because the Government lies in wait and exacts a large toll, going up to three-quarters of the wayfarer's income." This tax, he declared, forces the investment of capital in untaxed bonds, thus depriving trade and industry of capital urgently needed.

Both of these statements are unfounded. It is not true that our present industrial depression, with its five million idle workers, is due to lack of capital caused by the income tax. In the first place, there is no immediate need for capital to build more mills and factories. Our existing factories in practically every line of industry can produce more goods in nine months than we can consume in a year. With thousands of mills closed or running on half-time, with many of those producing unable to find markets for their products, it is evident that what the country needs to restore prosperity is not capital for new industries, but increased purchasing power by the one hundred million consumers. Present conditions, we are told, are due to overproduction. This also, of course, is not true. The real trouble is under-consumption, since millions of men and women need more and better food, clothing, furniture, and all kinds of goods. In any case, it is clear that putting more capital into industry could not materially help, so long as the mass of consumers cannot buy back the value of their labor product.

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Nor is it true that investment of money in untaxed bonds deprives trade and industry of needed capital. If Mr. A., in order to escape taxation, buys a $1,000,000 worth of untaxed bonds from Mr. B., the latter has $1,000,000, which he will either loan or invest. The game of avoiding taxes by buying bonds cannot go on indefinitely. No matter how often repeated, the process ends as it began, with someone having $1,000,000 to invest. There is no less money because of a change in its ownership.

The arguments in favor of repealing the excess profits tax are equally unfounded. It is claimed that this tax is shifted to the consumer, and so pyramided, with added profits, that it adds 23 per cent to the cost of commodities. No proof of this assertion has ever been furnished, and the fact that the big corporations are spending money to have the tax repealed is fair evidence that they have not been able to shift it to the consumers of their products. If it were true that this tax is shifted, why are the corporations so anxious to get rid of it?

As a substitute for the surtax on incomes and the excess profits tax the interests paying these taxes are urging the adoption of what is termed a sales tax, or tax on the manufacture and sale of goods. Various forms of this tax are advocated, but all agree that their purpose is to lift the taxes from great incomes and the excess profits of corporations. Against this proposal to add to the cost of living by taxing commodities the farmers and organized labor have vigorously protested, and their influence was sufficiently powerful to prevent the inclusion of any form of a tax on sales in the "tax-revision" bill passed by the House.

The advocates of the sales tax are now concentrating their efforts on the Senate. It seems unquestionable that the surtax on incomes will be drastically cut—at least 50 per cent, according to the expressed views of the majority of the Senate Finance Committee, of which Senator Penrose is chairman. Senator Smoot, who holds ideas on tax revision materially at variance with the other members of this committee, is nevertheless also in favor of cutting surtaxes to a 32 per cent maximum "so as to discourage investments in tax-free securities" and a "3 per cent manufacturer's sales tax," which he describes as "to be imposed only on the manufactured article and therefore does not pass to the retailers or the jobbers." How a tax which raises the price of an article is to be exorcised from being

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passed on remains a mystery. Secretary Mellon has declared in favor of repealing excess profits taxes and with President Harding has even been demanding a retroactive repeal to last January 1. Indeed the party in power is committed body and soul to the relief of "business." For the man in the street, for the average consumer, for the millions who, we are often told, "are America," whatever the Administration professes, it cares and does nothing. If there is one amendment to our present tax laws which ought to be made retroactive it is surely the raising of exemptions for men with large families, or the lowering of the percentage of tax charged on the first thousands of income. The Republican Administration, however, starts from the other end. Its chief concern appears to be the lowering of the tax burdens of the wealthy. And only a determined stand by the Senators from the great agricultural states, who recently have shown signs of intelligent cooperation, will defeat the purposed shifting of the tax to the consuming public. For there is no justification for the sales tax. It is impractical, costly, and wasteful in its administration, directly inhibitive of all efforts to reduce the cost of living, and designed merely to fill in the deficit which will inevitably confront the Treasury when the returns hitherto paid into it by corporations and individuals of means are cut off.

DIFFICULTIES OF THE SALES TAX[1]

The favorite remedy for all the ills the taxpayer is heir to is the sales tax; and a number of brokers, investment bankers and other business men are conducting a systematic propaganda or "educational campaign" to spread the gospel. One disciple calls the tax on gross sales "An Ideal Tax" and quotes with approval an enthusiastic convert who says that "the gross sales tax idea is as simple as A B C." According to members of the Committee on Ways and Means who recently drafted a sales tax, the reports about its simplicity are grossly exaggerated.

The sales tax has had a rather dark record in the history of taxation. Adam Smith regarded the *alcavala,* a Spanish tax on sales, as the cause of the ruin of the agriculture and

[1] By Thomas S. Adams. Needed tax reform in the United States. p. 14-16.

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manufacture of Spain. The conglomerate group of sales taxes which we employed during the Civil War did not on the whole work satisfactorily. However, it is fair to infer that the failure of these taxes was due very largely to the heavy rates at which they were imposed; and the 1 per cent sales tax now imposed in the Philippine Islands is said by competent authorities to be a successful and satisfactory tax.

A very great deal may fairly be said in favor of this proposal. The sales tax would perhaps possess the three greatest practical virtues which a tax can have; it would carry a very low rate; it would be highly productive, and the taxpayer would know with certainty the amount which he was expected to pay. If shifted to the consumer, as it is usually but not always predicted by its advocates, it would be paid piecemeal in small amounts as purchases were made. It would reduce the excessive dependence of the Treasury upon various forms of income taxation. These are great virtues and the low rate itself may fairly be said to counterbalance many of the weaknesses to which the sales tax, in common with all other taxes, is subject.

Three General Forms

Three general forms of this tax may be distinguished. The most inclusive—the general turnover tax—has, I believe, no real chance of adoption. Its yield at 1 per cent would be enormous, if not the $5,000,000,000 which have been claimed for it, certainly over $2,000,000,000 a year at 1 per cent. But it can hardly be conceived that Congress would consent to apply a tax of 1 per cent or even ½ of 1 per cent to every kind of sales—sales of farms and city homes; of the plant, business and assets of huge corporations; and of all other capital assets. It is really funny how each class believes that every other sort of business can bear such a tax. This is well brought out in the publication that calls the sales tax an "ideal tax." This proposes to apply the tax to all other turnovers except those "on the various exchanges—grain, cotton, stock, the sale of securities, municipal, corporation and others." This exception is made by a brokerage concern. There are, of course, many reasons for exempting sales on exchanges, but there are equally good reasons for exempting many other sales.

If sales of capital assets are eliminated, we reach the second

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form, a compromise between the general turnover tax and a tax on retail sales. Such a tax would yield from $700,000,000 to $1,000,000,000 a year at a rate of 1 per cent, according to the exemptions authorized. It would apply particularly to the sale of *goods, wares and commodities* whether for resale or not. It would thus have the cumulative or pyramiding effect frequently ascribed to all taxes on business. If there are on an average six turnovers between first production and final sale to the consumer, the 1 per cent tax would be imposed at increasing amounts six times. The tax would bear lightly on combinations or "trusts" which conduct under one ownership several of the operations usually carried on by independent business concerns. The combined business could undersell a group of independent concerns. The manufacturer who did his own jobbing would have a real advantage over his competitors who did not. The last characteristic is, in the words of one enthusiastic champion, "another virtue of the gross sales tax," and this advocate goes on to say that "a flat rate of tax on each commodity handled would, in the case of staples, eliminate a lot of rehandling and reselling of commodities."

Tax on Final Sales

The retail tax, or tax on final sales, would yield probably, at a rate of 1 per cent, from $350,000,000 to $450,000,000 a year, depending upon the exemptions. It would not apply to sales of capital assets, the pyramiding effect would be absent, and it would not foster combination. But it presents grave difficulties. The scheme depends for its success upon its generality and low rate. Bread, clothes, medicine and most necessities, when sold, are to be taxed. The tax rate is small and Congress is to be saved from the invidious task of selecting particular objects or classes for special taxation. This is the theory—but it almost certainly would not work out in practice.

First of all, Congress would be practically forced to exempt newsboys, and other very small dealers. The sales tax recently formulated by the Committee on Ways and Means exempted gross sales of less than $500 a month and later sales than $1,000 a month. Then we have the question of services. Should we tax the sale of bread and not the sale of the services of the actor or the lawyer? What about the sale of water or the

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services of public utilities such as transportation? Could the street railway shift a tax of 1 per cent, and if it could not is the average street railway company able to bear the tax itself? What of the farmer? His sales are exempt from the tax imposed in the Philippine Islands, and they were exempted in the bill drafted by the Committee on Ways and Means. But why?

Limiting the tax to *final* sales would create a difficult administrative problem. Merchants and other dealers would be required to secure affidavits from purchasers stating whether the goods were to be consumed or to be resold, either as bought or in some changed form. Would purchasers tell the truth? How about purchases of gasolene, coal and similar commodities or services which can be used either in business or for final consumption?

Certificates of this kind, distinguishing purchases for resale from purchases for consumption and use, are now employed in connection with some of the existing sales taxes; but they are said to lead to considerable evasion. It is an even question whether such a device could be successfully administered. In any event, the sales tax, like the income tax, would depend almost wholly on the honesty of the taxpayer for its successful collection. Experience with the income tax indicates that the honesty of the taxpayer, particularly in case of the larger business concerns, is capable of withstanding the strain, *provided an administrative force large enough to check and supervise the returns is employed.* The administrative problem would be a huge one, with almost every business concern in the country which sells at retail subject to the tax. This administrative burden could not be successfully carried, in the writer's opinion, unless the tax were used to replace some existing tax which, like the excess profits tax, imposes a heavy administrative burden. Few things could be worse than adoption of such a tax followed by wholesale evasion.

Consumer Would Pay

Just who would pay this tax? The general assumption is that the consumer would pay it, but the champions of the tax are at curious variance on this point. One advocate says on this point: "As to the very natural dislike which a retailer has

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for collecting a tax from his customer, that can be avoided by levying the tax against the merchant's net sales as they appear upon his books, leaving it optional with him whether he absorbs it himself or treats it as an item of expense to be passed along." Another equally zealous champion says in one paragraph that the tax would be "absorbed by the seller" and in the very next paragraph "that it would be equally paid by everybody in the country."

In the long run it is rather certain that such a tax would be borne by the consumer. But at present, with public opinion so inflamed about the high cost of living, and with a probable fall in prices imminent, it is probable that the tax in many instances would be borne by the dealer. It would to this extent become a business tax imposed without reference to ability to pay, but simply in accordance with gross sales whether there was any net profit or not. There is little or nothing to be said for a business tax levied simply in accordance with sales. And if the tax were passed on to consumers in the present state of public opinion, I have no doubt that in many instances it would strengthen the demands of wage earners for higher pay, act as an incitement to strikes, and in this way be passed along to the employers involved. While the cost of living remains so high, the sales tax is probably a political impossibility, as its recent treatment in the House of Representatives suggests.

Sober-headed business men are sometimes intoxicated by a sudden vision of utopia. This intoxication, as financial history amply proves, frequently leads to the championship of some "single tax." The legislative authority is to be spared all trouble by the blanket levy of a tax that is "as simple as A B C." But Congress could not work for one day on the sales tax without being forced to discriminate, to exempt certain classes and change the rate as applied to others. If we must discriminate, why not carry the tax to its logical outcome—a tax on articles of consumption other than necessities, levied preferably on a few large industries which deal in non-essentials of wide-spread consumption, in order that the tax may be effectively and cheaply administered. The people revolt at the suggestion of a general tax on necessities. The administrator revolts at the idea of another general tax, applicable to hundreds of thousands of business concerns, which could be adequately supervised only with a small army of Federal employees.

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A WAR SALES TAX DURING PEACE[1]

The proposition I desire to discuss is one which proposes to repeal the present tax producing about $800,000,000 annually under the excess profits tax, and imposing in lieu thereof a tax of $1,000,000,000 by what is known as a sales tax or a turnover sales tax. Every man in this House should be informed on that subject before he votes.

I will say this briefly, that there have been several men before the Ways and Means Committee, intelligent men, very able men, advocating the enactment of a general turnover sales tax, which, as you know, is imposed in Germany and in the Philippine Islands and in Mexico, the only three countries that impose it effectually. There they tax the sugar and tea, and everything that they eat and drink, on every turnover that may be had. The ablest body of men that has met in this country to consider this subject, known as the National Industrial Conference Board, has brought in a report showing how objectionable that system would be for this country. The United States Chamber of Commerce, through its tax board, acting intelligently and weighing all the arguments, has brought in practically a similar report.

Our Government is facing an annual tax burden five times the size of its pre-war expenditures. During the recent war large receipts were had from excess profits taxes on corporations and on personal income taxes due largely to the surtax. Congress now is facing a well-organized propaganda, based on assumed economic arguments for the repeal of the excess profits tax and for a reduction on income surtaxes. Another extensive, well-organized propaganda exists which demands the passage of a turnover consumption tax law with a sweeping tax on all necessaries of life, which bill is pressed for passage by Otto Kahn, Jules Bache, Meyer Rothschild, and others who have appeared before the Ways and Means Committee urging a turnover sales tax. Practically no opposition arguments have been presented to the committee.

Only limited study has been or can be given this vastly important subject by the average Representative in Congress, and

[1] From speech of Honorable James A. Frear in the House of Representatives. January 31, 1921.

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I am not assuming to speak against a sales tax from the standpoint of a tax student or tax authority, but from the viewpoint of a layman and legislator whose responsibilities are equally due to the banker, broker, and bricklayer, the capitalist and cobbler, the financier and farmer, the manufacturer and machinist, the teacher and day laborer, all of whom to a greater or less degree will help pay the $5,000,000,000 annual tax hereafter to be collected.

I desire to place before you the views of recognized tax students and authorities and shall introduce my own observations only briefly and for the purpose of calling attention to matters that have seemed to me worthy of consideration; but first as to the problems before us.

From the report of the Secretary of the Treasury I quote figures that briefly set forth the situation confronting Congress:

The gross public debt on Oct. 31, 1920, was	$24,062,509,672
Short-term debt in certificates of indebtedness Dec. 1	2,767,000,000
War savings securities maturing January, 1923	800,000,000
Victory notes due May, 1923	4,237,000,000

In round numbers we must provide for $7,500,000,000 by May, 1923. Whether by refunding or payment is a matter of policy to be determined. It is estimated that $1,250,000,000 must be raised by tax and set apart annually for interest and sinking fund.

Of expenditures by the Government for the fiscal year 1920, reaching $6,403,000,000, the following items composing 90 per cent are significant:

Secretary of Treasury Report, 1920, p. 48

Purchase of obligations of foreign Government	$421,000,000
War Department	1,611,000,000
Navy Department	736,000,000
Shipping Board	531,000,000
Railroads	1,037,000,000
Interest on public debt	1,020,000,000
Pensions	213,000,000
War-risk Insurance	117,000,000
Purchase Federal farm-loan bonds	30,000,000
	$5,716,000,000

During the second session of the sixty-sixth Congress total appropriations and authorizations reached $5,874,438,788.

An offset of an uncertain amount may be considered in war loans due this Government from various European Governments under the several acts of Congress beginning April 24, 1917, and ending July 9, 1918, for a total authorization of

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$10,000,000,000. Credits to an amount of $9,710,525,310 have been given and cash advanced by our Government of $9,580,823,677.

All interest payments on the above have been extended since the war at the request of the different Governments that are seeking to become rehabilitated. Another uncertain element of lower tax levy comes from a reduction in running expenses of the Government due to greater economy. We have then to consider probably appropriations by Congress based on the 1920 record of between $3,000,000,000 and $4,000,000,000 and payment of so much of the floating debt as can be cared for in addition to an annual interest and sinking fund charge of $1,250,000,000 as stated. That is our problem.

In the Secretary of the Treasury's Report, 1920 (p. 779), appears receipts for 1920 fiscal year as follows:

> Customs, $323,536,559; income and excess profits, $3,957,701,342; miscellaneous internal revenue, $1,441,447,870; other miscellaneous items and sales of public lands making total receipts for 1920 of $6,695,374,766.

It is conceded that these receipts will materially fall off in the future because of reduced excess profits and smaller individual incomes. In a letter from the Commissioner of Internal Revenue dated November 20, 1920, he says the actuary estimated Treasury receipts as follows:

1919:	
Individual taxes	$901,000,000
Corporation taxes	400,000,000
War and excess profits	1,300,000,000
	$2,601,000,000
1920:	
Individual taxes	1,400,000,000
Corporation taxes	650,000,000
War and excess profits	1,700,000,000
	$3,750,000,000

It is now proposed in some quarters to repeal the excess profits tax and reduce the surtaxes on individual incomes so that a large part of the above income will be lost. Even the Secretary of the Treasury advises a repeal of the excess profits tax, although he asks that it be replaced by some other form of corporation tax.

Constant assaults on the excess profits tax law from all directions indicate it is a friendless waif, not popular with those whose profits it has heretofore divided for the support of

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Government and it also seems probable, judging from opposition expressed against any new form of tax that no substitute will meet with general approval. One tax is insistently urged upon Congress in case the excess profits tax law is repealed. It is known as a consumption turnover sales tax and was vigorously pressed on the Ways and Means Committee last session in an effort to make it part of the revenue plan that was to provide for financing the soldiers' bonus bill, which bill finally passed the House.

What Is a Turnover Consumption Tax?

It is a reminder of the small boy's description of a toothache, "an abomination in the eyes of the Lord that does no man good." However, a consumption turnover tax will do everybody—good and plenty. It is a tax levied on every pound of sugar, salt, and starch that goes into family use from the growing of the sugar beets to its purchase at the store, on every pound of flour and other food, on every pound of meat from the farm to the packer and back again, on every pound of tea or coal, on every garment from the hat down to shoes and stockings, or, like an old-time description of a tariff bill, it is a tax from the cradle to the coffin. Every sale of wood from the owner to the logger, to the mill man, to the cradle or coffin factory, to the wholesaler, to the retailer, and finally to the customer pays the tax on every turnover with several times added for good measure, until the actual cost and actual tax join in a free-for-all price raising for the one hundred five million consumers who will pay an equal share of the increase. The wealthiest and poorest will pay the same tax, because a turnover sales tax plays no favorites from Vanderbilt to the humblest beggar when both must eat or starve.

During 1918, one person in this country paid on an annual income of over $5,000,000, two on between $4,000,000 and $5,000,000, eleven on between $2,000,000 and $3,000,000, forty-nine on between $1,000,000 and $2,000,000, and one hundred seventy-nine others on incomes between $500,000 and $1,000,000. Under a turnover tax these people would turn over the same amount of tax for the same food, drink, and wear as the poorest in the land. Fraud in omitting to report sales, which will be general, would penalize only the consumer. Administration by the Government would become a hopeless task, judging from past experience when every seller levies the tax with a generous margin on the goods sold whether the tax is reported or not.

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It is neither a just, equitable, nor enforceable tax, and I desire to present proof of these charges against the criminal at the bar—a turnover consumption tax.

Report of the Special Committee on Taxation of the Chamber of Commerce of the United States

It would seem that no careful legislator will be deluded by the arguments of a handful of financially interested advocates of a turnover sales tax, and the objections already presented are unanswerable; but another organization, the Chamber of Commerce of the United States, has aimed to give the same service to Congress on the same vitally important tax problem, and through its committee of nine tax authorities has also announced its findings on a turnover sales tax. The report of its committee against this tax is unanimous. I quote at some length because of the recognized high standing of this country-wide commercial organization:

A CONSUMPTION TAX—DIFFICULTY OF ADMINISTRATION

Various arguments have been brought forward in support of a sales tax, but in the opinion of the committee these arguments are overcome by important objections to any attempt to use such a source for Federal revenues. In the first place, the application of any of these taxes and its successful administration would not be so simple as is often supposed. In declining markets and under conditions of close competition turnover taxes would frequently have to be borne by the seller, and in many instances might for him be an added cause of loss. Even if passed on through addition to the price paid by the buyer, it would almost inevitably be pyramided, causing material increases in many prices paid by consumers.

RUINOUS EFFECT OF PRICE PYRAMIDING

There are still more fundamental considerations weighing against such a tax. One of the objections to the excess profits tax would apply with added force; this is uncertainty in yield of revenue, for gross sales fluctuate more widely than net income. If any form of turnover tax were imposed, it would result in advantages for large industrial undertakings which begin their processes with raw materials and carry them through to the finished product; such "integrated" industries would be subject to the tax but once, whereas their smaller competitors, acquiring materials from independent sources, would have the tax in their prices several times and probably increased in effect through pyramiding. Finished articles imported from abroad would have a similar advantage over domestic manufactures.

REPUDIATES PRINCIPLE OF TAXING ACCORDING TO ABILITY TO PAY

Perhaps the greatest inequity, however, would appear in the proportionate results of any of the taxes here under consideration upon the person with small income as compared with the person of large income. At the bottom of the economic scale are persons whose income barely suffices to provide them with necessities of the poorest quality and in the smallest amount, and at the other end of the scale are persons whose expenditures for necessities, no matter how large, represent but a fraction of their income. Any tax falling upon general expenditures is conse-

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quently disproportionately heavier for persons of smaller incomes as compared with persons of larger incomes. To the extent sales taxes of the sorts that have been suggested were used as a general source of revenue there would be a departure from the principle that taxes should be levied in accordance with ability to pay.

OF DOUBTFUL LEGALITY

Finally, there would seem to be legal difficulties in the way of a general sales tax. Opinions handed down by the Supreme Court in March and June of this year make it clear that such a tax is not authorized by the income-tax amendment to the Constitution. Whether or not it would be held by the courts to be an indirect tax is uncertain; if it were held to be a direct tax, it would under the Constitution, have to be apportioned among the States in accordance with their population, an obviously impracticable procedure. Reliance for revenues in large amount should not in any event be placed upon a tax regarding the legality of which there is doubt.

It must be kept in mind that these business interests are acting for their own protection because of the uncertain character of a turnover consumption tax. When it does not shift it threatens the industry compelled to pay it and when it shifts to the consumer, he is unjustly compelled to pay a tax now paid out of corporations' excess profits.

The authorities quoted will carry weight to most minds of the absolute danger attending a turnover consumption tax.

Experts Who Can Best Testify

Another list of authorities can be quoted whose names are legion. They consist of the farmers, clerks, skilled and common labor, housewives, and others not enumerated, who are glad to earn enough to get food and clothes and to give their children a common school education. They are the ones who will be called upon to pay 90 per cent and over of the proposed consumption taxes now paid by corporation excess profits and high supertaxes on personal incomes.

Any advocate of average intelligence, can safely take his case to this class of experts, and secure a verdict against a turnover consumption tax nine times out of ten, either in a judicial, legislative, or political forum, and the tax if passed, will be tried out, without doubt, by the last-named court and the one of last resort—the people at the first opportunity given to register their disapproval at the polls.

Whom Does Congress Consult in Revenue Legislation?

Presumably no more reliable adviser for Congress on revenues exists than the Secretary of the Treasury whose duty it is to properly and economically collect revenues and carry on the fiscal policy of the Government. He has for his advisers Gov-

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ernment tax experts and men of nation-wide reputation without private or personal ends to protect or advance. He is concerned in both revenue to be obtained and method of administration. In his 1920 annual report Secretary Houston condemns a proposed sales tax, as follows (p. 28):

In the Treasurer's opinion there are many grave objections to a sales tax. Further consideration of the subject has convinced me that a general sales or turnover tax is altogether inexpedient. It would apply not only to the necessities of life—the food and clothing of the very poor—but it would similarly raise the prices of the materials and equipment used in agriculture and manufactures. It would confer in effect, a substantial bounty upon large corporate combinations and place at corresponding disadvantage the smaller or disassociated industries which carry on separately the business operations that in many combinations and trusts are united under one ownership. The group of independent producers would pay several taxes, the combinations would pay only one tax. Finally, it would add a heavy administrative load to the Bureau of Internal Revenue which . . . is already near the limit of its capacity. Simplication of the tax laws and restriction rather than extension of its scope are as important from the standpoint of successful administration as from that of the taxpayers' interests.

Administration of a General Sales Tax

Mr. Adams, a Treasury income tax expert, says on this point in the Ways and Means Committee hearings:

If you have the income tax with all the necessary difficulties and you have the corporation tax with all its necessary difficulties and you have the principal present consumption taxes it is going to be a dangerous thing from an administrative standpoint to add a general sales tax which will bring in possibly a million new taxpayers to take care of, together with all the added complications of a new and nation-wide tax. . . (p. 28.)

His replies to questions of administration are illuminating:

Mr. Frear. How many employees does the Treasury Department have engaged in this particular work (collecting taxes)?

Dr. Adams. I shall have to ask you to let me put that figure in the record (these figures, p. 36, show 18,440 employees).

Mr. Frear. What would be the number of employees required in addition to cover the final sales tax in checking up?

Dr. Adams. That depends entirely upon the accuracy with which these reports were checked. You can simply put a sales tax on the statute books and leave it to enforce itself and it doesn't require very much force to handle it.

Mr. Frear. But you spoke yesterday of the different forms and that is my reason for going back to it.

Dr. Adams. And that ought not to be done. We are experiencing a perfectly enormous amount of evasion with respect to some sales taxes, such as are imposed by section 630, the soda fountain drinks and taxes of that kind, because we haven't got an adequate force to check them up and supervise them.

A 100 Per Cent Increased Price for Soft Drinks

It is certain that a 1 per cent turnover sales tax would be pyramided so that in a half dozen or ten turnovers the padded price in each turnover sale would make a ballooning of prices as wild in character and as burdensome in effect as were war-time prices. Two or three illustrations are readily available.

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During a hearing before the Ways and Means Committee December 21, Senator Hardwick, now governor of Georgia, was discussing the effect of a luxury tax on soft drinks when the following facts were developed:

MR. HARDWICK. Bottled goods that have a standard and uniform price throughout the country of 5c. were immediately increased to the consumer (after levying of a 1 per cent luxury tax or ½c. tax on 5c. sale) until the article that formerly sold at 5c. cost the consumer 7 to 10c. . .

MR. FREAR. Wouldn't that apply, Senator, to the sales tax ordinarily; that is, without relation to the exact tax which the seller will be obliged to pay? He will place upon goods a price that will make even change.

Mr. HARDWICK. I have no doubt in my own mind, speaking personally, that that is true, and I understand that the gentleman who presented the matter to your committee yesterday admitted that when that is passed on, ultimately, it always gains a little, like the snowball going downhill in wintertime. . . (p. 135.)

MR. FREAR. You say that these soft drinks were formerly sold for 5c.?

Mr. HARDWICK. Yes, sir.

Mr. FREAR. Then what tax was added by Congress?

MR. HARDWICK. 10 per cent.

MR. FREAR. Then the same soft drinks were sold for 10c.?

Mr. HARDWICK. They were sold at from 6 and 7 to 10c.

Mr. FREAR. In that case they added ten times the tax, did they not, if sold for 10c.?

Mr. HARDWICK. Undoubtedly.

This increase of 100 per cent in price or 950 per cent tax increase is submitted as a fair example of the workings of a sales tax, with increased price added for every turnover.

How It Works Now With Cigars, 400 Per Cent Tax Increase

Equally to the point and almost as greatly padded is the proposed price of a cigar from 8c. to 9c., because of a suggested increase in duty of $2 a thousand, or ⅕ of 1c. for each cigar. The following from the hearings of January 21 before the Ways and Means Committee illustrates the same evil:

Mr. LONGWORTH. How much would you add to cover that 1/5 of 1c. ($2 a thousand additional duty)?

MR. KRAUSS. We have no medium of exchange for selling goods at fifths of cents.

MR. LONGWORTH. How much would it add per cigar? As a matter of fact, you would add 2c., would you not, or would you add 1c.? How much would that add to the retail price? It would probably add 1c. so that there would be a profit of 4/5 of 1c. to the cigar?

Mr. KRAUSS. Not to the manufacturer; probably to the dealer.

MR. LONGWORTH. If the duty was added, that would be 1/5 of 1c. for each cigar. According to you that would add 1c. to the selling price to the consumer, or make a net additional profit of 4/5 of 1c.?

Mr. KRAUSS. Yes; provided you have those units to work with.

MR. LONGWORTH. . . And you say that would add 2c. to the cost of a cigar?

MR. KRAUSS. I did not say 2c., I said probably 1c., because there is not any intermediate method of exchange (p. 1363).

Mr. Chairman, that principle could be and undoubtedly would be applied to every turnover sales tax where the amount of tax was too small to have any other "intermediate method of exchange."

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It must be remembered that the soft-drink and cigar tax was not levied until the sale was made by the wholesaler or retailer to the customer, and these sales did not involve more than two turnovers with only one tax, whereas the proposed turnover sales tax sought to be enacted into law would mean a tax levied and collected on from eight to ten turnovers in some instances as have been heretofore disclosed.

Nothing need be added by way of argument to show how vicious and mischievous a turnover sales tax is certain to be when nothing prevents the cupidity of the seller, on the one hand, from taking advantage of the necessity or ignorance of the consumer, on the other, with a well-founded possibility that wholesale evasions of the tax or neglect to report will ensue, as stated in findings of the National Industrial Conference Board's committee.

Taxing and Padding From Producer to Consumer, 400 Per Cent Increase

Only one further illustration will be offered. When the railway bill was before Congress last session Director General Hines stated that an increase of $875,000,000 in freight rates would mean an increase to the consumer of $4,375,000,000, or 400 per cent increase, because, as stated by Chairman Woolley, of the Interstate Commerce Commission, "The shipper passes this along to the consumer and on back to the producer of the raw material, who has to stand the cost of transportation."

The effect of increased freight rates that has served to prevent any reduction of ordinary commodities to pre-war prices from a riot of padding and ballooning of prices is also made possible in a sales tax under the beneficient consumption turnover tax plan.

Sales Tax Laws, Where and How Enforced Today

Without attempting to set forth specific terms or scope of existing sales tax laws it is noted that:

Canada's sales tax law of 1915 (assented to July 1, 1920) provides for a tax on banking and negotiable instruments. The tax is laid on final sales of various luxuries and on high-priced wearing apparel not ordinarily worn by 10 per cent of the people with a minimum price fixed by law above which the tax applies. A tax also is collected on goods sold by wholesalers and jobbers, but not on plain foodstuffs.

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The French turnover tax (1920) applies to luxuries set forth in schedules A and B of the law as distinguished from necessities and is much like the Canadian law, in that it does not reach necessary foodstuffs. The French law was passed by a Government with less than one-third the estimated wealth of our own and with a national debt of $46,000,000,000, or double our own after crediting foreign loans. Its sales tax law, enacted to meet a critical national financial emergency, has been in force less than one year, but actual receipts have only reached about 47 per cent of those estimated by its advocates when the law was passed. Due to many exemptions and presumable difficulties in administration, Canadian receipts from the sales tax in that country are in like manner disappointing.

The Philippine, 1917, Mexican, 1906, and German, 1920, turnover taxes should each and all delight the hearts of Messrs. Kahn, Bache, and Rothschild, leading exponents of the tax here, although the gentlemen named have not found any of these countries sufficiently attractive to renounce citizenship or residence in the United States because of more agreeable tax laws to be found elsewhere.

The Philippine, Mexican, and German Turnover Tax

The Philippine tax has been pointed to as a model for the United States. Industries in the Philippines are largely found in or around its one large city—Manila—and due to isolation of the islands the law is not difficult to administer. This turnover sales tax is a relic of the old Spanish régime, and the tax was also laid by Spain on Mexico. It is a legacy from a Government that notably failed in its cruel administration in both these countries, and curiously enough no law of the kind is in effect in Spain. I quote hereafter as to the Philippine and Mexican methods of administration, if to be applied here, based on statement of H. B. Fernald, of New York City, before the industrial tax board—page 66, hearings.

It is also noteworthy that a statement from Martin R. Bourne, of New York, urging the Philippine sales tax on Congress, claims the same rate of tax which raises $7,000,000, or $1 per capita in the Philippines, will raise $2,000,000,000, or $20 per capita, in the United States. In view of the further argument that a sales tax is practically a poll tax based on consumption of each taxpayer, the effect of the argument is

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clear that the American citizen will pay twenty times as much as the Filipino under the same kind of tax.

Germany's turnover tax law approaches the ideal tax pictured by advocates of the system. Its name there, "umsatzsteuergeset," comprehends several turnovers at the outset. The law levies turnover taxes on sales, both wholesale and retail, but its exemptions thoughtfully cover a number of banking transactions, including exchanges of bank notes, paper money, and so forth, which exceptions would presumably be urged by "experts" for any law enacted here.

A tax of 1½ per cent on necessaries, 15 per cent on sales classed as luxuries, and 10 per cent on all advertisements not connected with public elections in Germany contribute toward the $57,000,000,000 indemnity burden recently levied by Great Britain, France, and Belgium on a defeated foe, but why should Messrs. Kahn, Bache, Rothschild, or Goldsmith, its advocates here, collect their pound of flesh from the American laborer, whose needs are to be substituted for excess profits taxes just because that tax is yielded up in Germany through force of arms?

England has repudiated any turnover tax sales law, root or branch. Canada and France are conducting very limited experiments with luxury taxes that are disappointing and irritating in administration and revenue.

The only turnover sales tax laws in Governments of comparative importance are found in Mexico and Germany, where the iron hand of revolution has turned over Governments and ruthlessly imposed turnover taxes as one of the chief fruits of revolution.

Do we want such laws for the United States? If so, why?

Who Is Pushing a Turnover Sales Tax?

Let us now examine the "experts" and authorities (?) who are pressing a turnover sales tax on Congress. Singularly enough, none of the twenty members of the tax committee representing two of the largest commercial organizations in the country were called before the Ways and Means Committee to give us the benefit of their study and investigations, nor do these important reports appear anywhere in the hearings, nor has any reference been made to them to my knowledge.

Practically the only witnesses who have appeared before the

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Ways and Means Committee, aside from Dr. Adams, of the Treasury Department, are Julius Bache, a banker and broker, New York City; Otto Kahn, a banker and broker, New York City; and Meyer Rothschild, also from New York City; although Mr. Klein and Mr. Goldsmith, "accountants," also appear on different phases of the income tax law as it affects their clients.

The Sales Tax Versus a Head Tax

A short expeditious tax collection has been suggested by other authorities, that may yet be urged by Messrs. Kahn, Bache, Rothschild, and Goldsmith on Congress. It is much simpler than the excess profits tax law, which causes these income authorities to spend sleepless nights in preparing tax reports. It will save them the necessity of investing their large incomes in tax-exempt securities in order to avoid the higher surtaxes. In fact, while it resembles a turnover sales tax, so ably defended by these gentlemen, in that it would reach every man, woman, and child through the food and clothing individually worn, yet it would save the objection of profiting and tax pyramiding, which is a conceded evil of the turnover sales tax. It also reaches to the very base of fundamental taxation.

It is urged Congress could reach the same result advocated by Messrs. Kahn, Bache, Rothschild, and Goldsmith and at the same time avoid a needless pyramiding turnover tax by enacting a poll or head tax. By transferring the $1,000,000,000 of excess profits and surtaxes that now worries those obliged to pay such taxes over to a poll or head tax the tax could not be avoided by the taxpayer and collection annually would then be as easy as taking the census.

Messrs. Kahn and Bache might urge it be provided by law that the head of the house would pay a tax levy of $10 per head for each member of his family, based on the per capita share of each inhabitant who is now asked to shoulder the $1,000,000,000 tax burden of the rich. If any tax was not promptly paid, it might hamper the Government to put the wage earner in jail; so, like the good old distress-for-debt practices in Germany and England, from which some of our modern sales tax authorities spring, the law might seize a member of the family, say one of the children, who Bache says will not pay anyhow if it does not consume, and the wage earner would then be left free to earn the tax.

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Large Taxes from Large Families a Certainty

Take the case of Mr. Bland, a constituent of Congressman Small, with twenty-six children; his head tax of $10 each would reach $280, which would include himself and his wife. In the case of a constituent of my own, with seventeen living children, he would only have to raise $190, which would include himself and wife. Of course, these farmers are also paying local taxes on their farms for the support of their schools, local improvements, and State institutions, but they might put in a few extra hours daily in earning the extra tax that Messrs. Kahn, Bache, Rothschild, and Goldsmith would then have taken from their own shoulders, and thus we would avoid the need of a general pyramiding sales tax.

The system suggested would possess the additional virtue of having direct action, and that is what these New York bankers are seeking. True, Bland, the farmer is probably working fourteen hours a day already, while Kahn, Bache, and Rothschild have a minimum unwritten law of nearer four hours, and there may be other matters of detail that would arise, but, as Mr. Kahn well says, "No law is absolutely perfect." However, such a law would solve the mental struggles of excess profits taxpayers and is well for them to consider as an alternative for the sales tax.

Of course, Congress would take an extended leave of absence after passing any such measure, and probably the next Congress, of different Members, might enact an extreme capital tax which would get more quick profits than under the present excess profits tax system; but as a temporary relief it is submitted that the kind of a tax for these distinguished gentlemen to advocate is a head tax, or poll tax, although the latter term would have a singularly unpleasant sound to those who had to submit their candidacies at the polls after enacting the law.

Prejudiced Tax Experts

Speaking personally, I believe Messrs. Kahn, Bache, Rothschild, and those they represent should be made to pay every dollar of taxes due from them under existing laws, and they should pay taxes according to their ability. Any attempt to avoid payment of taxes by investing in tax-exempt securities ought to be met, so far as possible, by drastic legislation until a constitutional amendment can be passed.

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The tax dodger of today is not the poor man whose home and farm is immediately sold for taxes, with stiff penalties when it is redeemed. He can not avoid payment of his taxes by investment in tax-free securities or other means, and every dollar spent by him for taxes is ordinarily taken from some need of the family.

The tax dodgers and prejudiced tax experts are not found among this class of people, but the man who unblushingly tells the Ways and Means Committee he is investing his surplus cash in tax-exempt bonds; who publicly says he spends eleven months of the year studying how to evade our tax laws; who says if the poor do not want to pay a sales tax they need not consume; who unblushingly declares in one breath that he shifts all his taxes over onto the ultimate consumer, while in the next breath he demands a repeal of the excess profits tax, because it is a heavy burden on the rich; the wealthy banker who pompously says to the country in his six by nine pamphlet that only one man on the Ways and Means Committee understands the revenue question, and, therefore, he—Bache—must come to Washington in order to instruct the committee regarding the tax he wants—this kind of tax expert will find new apologists, even among his own fellows, and he is out of touch with 99 per cent of the one hundred million people for whom he asks Congress to pass a sales tax law.

Who Will Pay the Sales Tax?

Let us for a moment study a picture of human existence and the proposed taxation scheme.

Of the one hundred six million people in this country it is doubtful if 1 per cent are making $5,000 annually, mentioned in one discussion by Mr. Kahn, nor do they pay any appreciable income tax. Ninety-five per cent certainly are among those who grub along for less, and half of the total presumably are living on net incomes of $1,000 or less received by the family breadwinner. This amount has not much more than one-half the purchasing power of ten years ago. In other words, the astounding report that a large part of labor received $700 or less annually ten years ago was no more serious than conditions of today—particularly when over two million breadwinners are out of employment. Immaculately dressed Messrs. Kahn, Bache, Rothschild, and Goldsmith do not represent these people.

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Those they represent who clipped bonds or interest coupons during the war then took no chances. Their living expenses, luxuries, and limousines never occasion them worry now. Yet they protest against turning over to the Government part of their "excess" profits, not of their reasonable profits but a part of their "excess profits." They declare that individual enterprise, ambition, and initiative will be hampered by parting with any excess profits.

Of the one hundred million people whom Congress represents, I believe statistics would show 90 per cent are no better off today financially than before the war, although the great demand for labor during the war is so recent that the country has not yet recovered from its financial orgy to take an accounting of stock. That is the situation confronting the country and Congress when Messrs. Kahn, Bache, Rothschild, and Goldsmith demand that "the burden now upon the rich," to use Kahn's words, must be shifted to the one hundred million. In other words, that an income of over $1,000,000,000, counting the excess profits, collections, and higher surtax now paid by less than 5 per cent of our people, must be shifted over to the backs of the remaining 95 per cent by a consumption tax. Under that beneficent proposal every turnover tax will be paid as stated from the time sugar beets are first sold to the last sale of refined sugar by retailer; from the sale of wheat at the elevator to the final sale of bread or breakfast food by the grocer; from the sale of the steer or hog by the farmer to the sale of shoes by the retailer or wienerwursts by the lunch stand—and for every eater of porterhouse a score patronize the wienerwursts.

Pyramiding From Producer to Consumer—Where Does the Retailer Come in?

From five tax levies to ten tax levies are made between the first sale and the last of the completed article, depending upon the "turnovers." The tax may be insignificant but after witnessing the cupidity, greed, and profiteering of the past three years in America, the public must pay, irrespective of cost or reasonable profits, and no sensible man believes that the tax added to the article by the different middlemen from first producer to final consumer will be that fixed by law. If it is 1 per cent with five turnovers it is more likely to be 25 per cent by the time the many turnovers occur and before the

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finished article is received the turnover tax and much more, is pyramided each time and is added to the cost of the article on which the next turnover tax is levied, as had been disclosed by Senator Hardwick. In many cases it is fair to suppose that where the Government would receive a total of 5 per cent in taxes on the different values for that sold, the consumer will pay from 25 per cent to 50 per cent or even 100 per cent additional, 90 per cent of which additional charge will go into the tills of the different turnover dealers. That is one reason retail merchants and other dealers have no fault to find with the turnover sales tax plan and are easily caught by the argument.

That is a reason why Mr. Lew Hahn, managing director of the National Retail Dry Goods Association, is said to be in conference with "members of the Senate Finance Committee and of the Ways and Means Committee of the House" (Washington Times, January 25).

These retailers do not pay the sales tax which Mr. Hahn and Mr. Kahn and Mr. Bache and Mr. Rothschild and Mr. Goldsmith favor. The retailers are the ones who will pyramid prices and collect from the consumers large margins even as they try to do today.

Notwithstanding manufacturers and wholesalers have slashed prices to retailers according to published statements, the large retailer still charges his heavy profit without yet having learned that the war ended more than two years ago. The retailer has nothing to fear from the turnover sales tax because he does not pay it—he passes it on to the consumer and his advocacy of the sales tax is entitled to close scrutiny particularly if he is now seeking to escape paying an excess profits tax through the shift.

Everybody to Pay the Same Tax

A sales tax hits the ultimate consumer who generally pays the final bill, including freight bills, taxes, and every charge that goes to make up the last selling price. All people will pay the same and thereby can learn the blessings of taxpaying in real earnest. The molder in the foundry will pay the same as Otto Kahn, banker, for his sugar, with the same profits and tax added in both cases; the miner digging coal will pay the same as Jules Bache, New York banker, for the meat, flour,

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and potatoes with the same tax added; the farmer will pay the same as Rothschild and Goldsmith for the same grade of shoes, shirts, or clothes, with the same tax added although neither Kahn nor Bache nor Rothschild will draw heavily on the kind of goods the farmer or laborer wears. The workman with his flivver will pay the same tax on his gasoline that Rockefeller himself pays, in order to pile up excess profits for Standard Oil that are no longer to be taxed according to Messrs. Bache, Kahn, Goldsmith, and Rothschild.

The farmer will pay the new price for his axe and other tools that Carnegie exacts through the Steel Trust, and the excess profits tax formerly paid by the trust is now to be shifted to the final purchaser—in order not to destroy initiative in business. The soldiers whom we sent to war to protect the property of Kahn, Bache et al. from German tribute—these men who saved the day—will now pay the same turnover tax as Kahn et al. This is the beneficent scheme known as a consumption tax, or a turnover sales tax, that these bankers and financiers ask Congress to place on the backs of the one hundred million people whom we represent.

Inflation and Deflation Laid to Taxes

In a hope of escaping excess profits taxes the proponents of the repeal paint in somber colors the terrible distress of business occasioned by the excess profits tax and the beautiful picture of every man bearing his own share of the burden under a consumption sales tax.

Every business reverse, every annoyance, is laid to the excess profits tax. When prices were high Kahn et al. claimed prices were high because the excess profits were always added. When the balloon burst and prices dropped Kahn et al. pointed to the drop as a business distress caused by the drain of an excess profits tax. Notwithstanding the tax only reaches a part of the excess profits over reasonable profits of 8 per cent, the tax is protested by many men who pay it in the same breath that they confidently declare they pass the tax on to the other fellow.

One ounce of fact is worth a ton of theory, and a few unprejudiced witnesses are worth all the Kahns, Baches, Rothschilds, and Goldsmiths in the universe who are special pleaders for special interests.

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As heretofore stated, several hundred witnesses appeared before the Ways and Means Committee on tariff schedules. They employ hundreds of thousands of men in the aggregate and have paid many millions of dollars in excess profits taxes on their factory earnings in the aggregate, yet not one of these men complained of the excess profits law as a hindrance to his business nor as a bar to incentive. Search the hearings of these hundreds of witnesses and not one seconds the demand of Messrs. Otto Kahn, Jules Bache, Rothschild and Goldsmith, bankers, brokers, and special pleaders. What more significant illustration of the difference in attitude between the coupon-clipping and stock-market juggling business compared to actual producers, employers of labor, and contributors to the country's prosperity. It is the difference between the broker and the producer, whether he be farmer, factory hand, or manufacturer.

Real Tax Authorities versus "Wabblers and Waverers"

Thus far I have presented to you the findings of two important tax committees, representing thousands of manufacturers and hundreds of chambers of commerce throughout the country. These findings in both cases specifically repudiate a consumption tax and point out dangers which would not occur to novices or superficial students of the subject. I have also quoted from the Secretary of the Treasury's report specifically rejecting a consumption tax both in principle and as an administrative proposition.

Quotations have also been furnished showing conclusively that taxes are loaded and this heavy load in addition to the tax will be passed on to the consumer under a turnover consumption tax.

These high authorities are opposed by several New York bankers, brokers, and accountants, one of whom, Mr. Kahn, has "wabbled and wavered" for many months and has not yet found his equilibrium. Mr. Bache goes Mr. Kahn one better, as I have shown, and says all income taxes and all corporation taxes should be wiped out and a turnover consumption tax substituted. He adds that he is placing his own funds in tax-exempt securities as rapidly as possible. Mr. Rothschild believes like Mr. Bache, but does not advocate going the limit at this time. These three experts were before the National

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Industrial Board tax committee and their untested theories were there rejected. However, they are persistent; they have millions of dollars in annual taxes at stake among those they represent; they have a vigorous, expensive propaganda and are well organized.

They were practically the only witnesses, by a curious circumstance, on the subject before the Ways and Means Committee, except Dr. Adams, who opposes a turnover tax, and Bache informs the country in this pamphlet that he has grapevine intelligence that Adams does not count with the Ways and Means Committee when it comes to preparing a bill. These are the financially interested witnesses who are seeking to have Congress relieve them of their taxes and to saddle their tax burdens on the general public.

They point to Canada, Philippines, and France to prove that a turnover sales tax is desirable for the United States. At the risk of appearing to give undue weight to their arguments, I will quote from the opinions of men who have given the tax subject here and abroad profound and exhaustive study. If the conclusions of the tax committee, already quoted, were convincing, the reasons advanced by the following witnesses are conclusive:

Testimony of Tax Experts Against a Sales Tax

Arthur A. Ballantine, attorney at law, New York City, formerly Solicitor of Internal Revenue, says, page 32, hearings National Industrial tax committee:

> I believe that this idea of a sales tax, a tax collected everywhere, falling on no one, is a will-o'-the-wisp which has floated over this field of taxation and which is in danger of luring business men who approach Congress in an effort to get really beneficial changes into futile action instead of constructive action.
>
> I believe that this committee, by the very careful and exhaustive consideration which it has given to the advocates of this plan and its careful thought as to conclusions, has done much to dissipate this myth and to direct the efforts of business men into practical channels instead of down a pathway which leads to futility.

For the second witness I quote from Charles A. Andrews, whose frank, clear analysis of the sales tax is illuminating. He says (p. 38):

> There was on the committee no vociferous objector to the sales tax. There was on the committee nobody who was loaded to kill it. We started in upon the assumption that we were going to work out something in the form of a sales tax. We invited various well-informed people to come before us. We reached out and got printed matter and manuscripts;

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we made investigations; and slowly but steadily the committee was driven to the inevitable conclusion that it, representing a large body of business men, could not bring before this conference a recommendation for any form of sales tax, except as the same related to a few specific articles, suggestions as to which we have made, and which have been referred to by Mr. Armitage.

We haven't the nerve, as good citizens of the country—which we believe we are, and are trying to be—to say to a body of business men in this country, who are suggesting that business be relieved from a billion dollars of excess profits tax, that we propose a tax which will cause the billion to be paid by the ultimate consumer. That is such a violent divergence from the principle of payment upon the basis of ability to pay that we can not ask this body of business men to get behind that sort of a tax.

We do not believe, in this day and generation—and following the World War, instead of following the Napoleonic wars—that we have any business to propose seriously to the Congress of the United States a tax of a billion dollars, or two, or three (I don't know how much it would produce—all those figures are given), to be paid by the ultimate consumer, and organized business excused from its $1,000,000,000 of excess profits tax.

We don't think that is good citizenship; and we don't think that is good economics. That is the real reason that we disposed of or rejected the sales tax, upon the assumption that the tax is paid by the ultimate consumer.

Well, let us assume that the tax all remained with the original payer of it, and that it is not passed on to the consumer. Does it then become a tax which we can justify ourselves in recommending to Congress? Your committee says "No." . . . "Why? If the tax remains with the individual or concern which originally pays it, and he is not able to pass it on, it becomes a tax measured in terms, although not so stated, of his gross receipts; and as such, in the opinion of your committee, it is open to such serious objections that we can not ask Congress to pass it. . . A tax on gross receipts which leaves out of the equation all the difference in cost of the conduct of your business as compared to mine—perhaps it takes 90 per cent of my gross receipts to conduct my business and pay my expenses; perhaps it takes 50 per cent, or 70 per cent, or 95 per cent of yours—is an unjustifiable tax. . . The establishment of a tax like that would, in the opinion of your committee, produce such inequalities that our dissatisfaction with the excess profits tax would be as nothing, and we would find ourselves in the face of inequalities vastly greater than heretofore. . . It is uneconomic in its nature; it is indefensible in our opinion, in the twentieth century, if it is a general tax on all consumptions; and for other reasons it is equally indefensible if it becomes a tax in terms of gross receipts, which term means nothing so far as it relates to the ability to pay taxes.

Bache Shows How to Avoid a Consumption Tax

Mr. Jules Bache, called as a hostile witness before that committee, gives his own concept of human nature and a cold-blooded alternative for the ultimate consumer who can not pay the tax. He says, "Quit consuming." I quote from his statement before the industrial committee (p. 58):

Professor Adams this morning showed the greatest optimism that I have ever heard voiced from the tribune. He states that he believed the taxpayer was a cheerful, voluntary honest man. That is not my opinion. The taxpayer—and I am not attacking his honesty when I say so—spends eleven months a year devising schemes by which, during the first month that he tries to make up his tax statement he can avoid as many of the taxes as is legally possible, and he generally succeeds in avoiding many of them.

The idea of putting a thrift tax into our taxes, which the 20 per cent

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limitation would be, is an excellent one, but the greatest thrift tax would be the turnover tax, since if anybody didn't want to pay any taxes he could merely refrain from consuming.

The Canadian Tax Is Not a Sales Tax

W. C. Cornwell, an employee of Mr. Bache, read a statement of the Canadian sales tax at that same meeting (page 60) to which Robert G. Wilson, chief of the tax division, American Mining Congress, immediately replied as follows:

I don't know how many gentlemen present are familiar with the Canadian law, but it has been my fortune within the last three or four years to spend some time in Canada, and, for business reasons, make some intensive study of the Canadian law. To my mind the Canadian law is not a sales tax.

In the first place, the law of July 1, known in the United States as a sales tax, is an amendment to the special war revenue act of 1915, which is an excise tax law.

What Mr. Cornwell has had to say regarding the premier's statement is true. The statement, however, is misleading in that it refers to a sales tax which, in its effect, exempts all the prime essentials of life from such taxes; it is only an addition at the rate of 1 per cent and 2 per cent to excise taxes—luxury taxes, if you please—which rise sometimes 50 per cent upon many commodities—luxuries, essentials, and non-essentials. It is not, as the business men's tax committee has termed the proposition, a sales tax.

The next witness, Mr. J. F. Zoller, tax attorney of the General Electric Co., says at the same committee hearings, page 62:

I want to talk just a minute on the sales tax. Now, we have reached the parting of the ways here in regard to the sales tax. Personally, I am opposed to it for the reasons stated by Mr. Andrews. I can't state those objections any better or as well as he did. But the situation as I see it is this: The people who are favoring the sales tax are those who are already required to pay a sales tax under section 900 of the present law, and their position is that if the Government can select this industry and impose a sales tax upon us, why not spread it to other taxpayers?

The Philippine Tax Discussed

Replying to a statement filed by a Mr. Hord, formerly collector of internal revenue of the Philippines, the next tax authority, Mr. H. B. Fernald, of Loomis, Suffern & Fernald, New York, says, page 66:

The sales tax has been spoken of as if it were a new thing of very recent years. From my experience with the sales tax I go back to two things—one is the matter of the Philippine tax, the other the matter of the Mexican tax. . . Do you want to place in your business a proposition where every purchaser is to get a receipt on which you are to affix serially numbered stamps and where you have to account for all your stamps purchased and issued, subject to examination from time to time, to check up as to the number you have left and when you purchase them, and where you have to put down the last serial number you purchased and the serial number you are acquiring now?

My objection to the sales tax is particularly from this standpoint, and it is the same thing which will apply to almost any tax, namely, when a tax gets large in amount and it becomes worth while the taxpayer will look for a means to avoid it. . . It can be eliminated; it can be gotten around. The experience in Mexico has shown that conclusively, and therefore it is a tax which will be paid by the small man, while the large man, who is able to change his business organization, can avoid it.

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Why England Rejects a Sales Tax

The next witness is James J. Forstall, of Chicago, attorney at law and member of the tax committee, who speaks of efforts to pass a sales tax in Great Britain, the former home of Mr. Kahn. He says (p. 67):

Comment has been made on Canada and Mexico. I would like to say that two weeks ago yesterday, through the courtesy of Professor Haig, I had an opportunity to discuss with one of the members of the British income tax commission and with one of the high tax officials of the British Government the question of the British taxation situation. As you probably all know, they have about as little love for the excess profits duty as the Americans have for the excess profits tax, and have been spending two years in trying to find a substitute, but they haven't yet found it. I asked each of those gentlemen whether the general sales tax has been considered as a substitute, and they both said the same thing: That it had been taken up and considered very seriously, but that now they were no longer considering it, because they were convinced that it was neither an equitable tax nor feasible from an administrative standpoint, nor one which could possibly be passed through Parliament.

The Cumbersome Mexican Sales Tax Law

For the next witness I quote from A. E. Holcombe, New York, secretary and treasurer of the National Tax Association. He says:

I happen to have with me a copy of a bulletin which is just about to come out, and in view of the references to other countries I thought I might read a couple of sentences from the report on the Mexican situation. It seems that early in the Carranza régime he established a committee to look into the entire financial system in Mexico. That committee made an elaborate report, and it has been reviewed by Professor Chandler, of Columbia, who spent some time himself as adviser.

It is perhaps not too much to say that the most important proposal to be found in the entire model plan (and that was the name given to this report) is that recommending the suppression of the sales tax throughout the States of Mexico. . . . It has always been a costly tax to collect, and according to the opinion of Mexican officials, who are in a position to know, it has constituted one of the most cumbersome impediments to industry and commerce.

How Farmers Regard a Sales Tax

The next witness, J. R. Howard, of Chicago, speaks for a million and a half farmers in the American Farm Bureau Federation. He speaks the sentiments of several million other farmers not connected with the organization, of which he is president. He says (p. 68):

The farmer is interested in paying his just and fair proportion of taxation. He believes every man, every citizen, should pay some tax, because it makes him a better citizen, but he believes that that taxation should be so distributed as to be fair and equitable, and in proportion to each man's ability to pay.

With regard to the sales tax, let me say that the farmer occupies a unique position. I think it has generally been conceded in this discussion that the tax is passed down to the ultimate consumer. The farmer can pass nothing to the ultimate consumer, because he buys at the other man's price and sells at the other man's price, and being at that

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disadvantage and not able to pass it on, he bears on unjust burden and is in a place where I am sure he, as a farmer, will object to the broad extension of the sales tax principle.

Mr. H. C. McKenzie, of Walton, N. Y., a member of the tax committee, seconded Mr. Howard's testimony in vigorous language, as follows:

I want to take the opportunity to emphasize the farmer's objections to a general sales tax, which have been voiced by our president, Mr. Howard, and to call your attention to just two or three things briefly. . . The chief proponent of the sales tax has told you that the excess profits tax is not only paid by the ultimate consumer, but that the ultimate consumer pays the tax two or three times in amount. Now, if that is right, the corporations and people who are doing this business are receiving a benefit from the excess profits tax, and the corporations and business people are the people who are asking for its repeal; they are asking for something that is diametrically opposed to their own interests. According to the chief proponents of the sales tax, the sales tax is paid by the ultimate consumer in its entirety; that is his proposition, as I understand it.

Now, your proposition, as developed by the advocates of the sales tax, is this: To take an approximate $1,000,000,000 off the excess profits tax, which is now paid, as I contend, largely by the corporations, and put it over, according to the proponents of the sales tax, on the ultimate consumer. It seems to me that nothing could be more shortsighted and tend in the end to be a boomerang, and to be a disadvantage not only to business but to capital than to strive to shift the burden of a billion dollars from the business people who now pay it to the living wage—which is what it amounts to—the ultimate consumer. Ninety per cent or 95 per cent of that tax will be paid out of the living wage, if the contention of the proponents of the sales tax is correct; and I want to say that the farmers who are represented in the American Farm Bureau Federation will never in the world stand for that proposition.

"Farmers Will Fight to the End"

Let me interject a witness at this point whose tenderness for wealth and capital has no conspicuous place in his published statement, from which I quote. I offer an extract from an article given to the press a few days ago by George P. Hampton, managing director of the Farmers National Council, an organization representing an enormous constituency. No one will doubt that equally forceful demands are voiced by the millions of organized and unorganized labor who are to be placed in the new class of turnover sales taxpayers. Mr. Hampton says:

In 1918 [Mr. Hampton states] 22,696 millionaires were estimated by the eminent publicist, Mr. Richard Spillane, to own 27.2 per cent of the national wealth, or over $68,000,000,000, while the thirty-three richest Americans owned property worth about $4,837,000,000, or, roughly, 2 per cent of the national wealth. In 1918 the national wealth was estimated to be $250,000,000,000. It is now estimated to be $500,000,000,000. Our twenty-three thousand millionaires are probably worth now about $136,000,000,000, and the thirty-three richest Americans about $9,675,000,000.

If we estimate the net return on this property at only 5 per cent, the average income of these twenty-three thousand millionaires is nearly $300,000. Of course many of them have invested largely in tax-exempt bonds and own a considerable proportion of the $40,000,000,000 of such tax-exempt bonds. While a constitutional amendment would enable the

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Government to tax the income of these individuals, it will take some time to adopt such an amendment. A direct tax, however, could be levied upon capital values, and should be promptly levied by Congress instead of seeking some method of placing additional burdens of taxation through a retail sales tax, a general sales tax, and other consumption taxes upon the hundreds of thousands of families who today are receiving several hundreds of dollars less than they need to maintain the American standard of living. . . A retail sales tax and other sales taxes and all similar taxes on food, clothing, and shelter, called consumption taxes, must be paid chiefly by the workers on the farms, in factories, mines, and transportation, millions of whom are getting less than the minimum wage necessary to maintain a family on a decent American standard.

Mr. Hampton concludes:

The full money cost of the war must be paid by taxes on incomes, corporation profits, estates, and privileges. Such taxes will yield $7,000,000,000 to $8,000,000,000 a year for many years without imposing any hardship upon anyone. American farmers, who this year have lost billions through the slump in farm prices, will fight to the end the plan for the selfish privileged interests to saddle the huge war debt upon our people for years, and insist upon prompt payment of that debt by those who profited so hugely by the war and by the monopolies built up in this country before and during the war.

A Recognized Great Tax Authority on the Sales Tax

I could quote from many other witnesses who have not "wabbled and wavered" for months, but the witnesses I have cited against the sales tax are tax students and authorities, men who have given the question thorough consideration in most cases, are apparently unprejudiced, and whose views are of great value in determining matters of taxation. One of the greatest international tax authorities, whose textbooks are known to every student of taxation, has expressed himself on the subject of a turnover sales tax as late as October 22 last. His contribution on the sales tax here and abroad is concise, fair, and positive. I quote from the statement of Dr. E. R. A. Seligman, of Columbia University (National Industrial Tax Committee hearings, p. 72):

The sales tax is not a novel tax, as the Premier of Canada said. If he has followed an academic course in taxation he could have learned of many examples, dating back as far as thousands of years ago. The Romans had it, not to speak of the Egyptians and the Babylonians. I do not want to give a lecture on taxation; I am simply trying to call attention to the fact that the sales tax has existed in one form or another for a great many years. With only two exceptions, it has been abolished everywhere and has not been reintroduced in any first-class country, and those two exceptions are Germany, which reintroduced it in 1919, and France, which, as has been said, introduced it in 1920. Now, before we consider the experiences with this tax, it must be remembered that we can learn little one way or another, either for or against it, from Mexico, or Cuba, or the Philippines, or Canada, all of which are countries of insignificant economic proportions, where we do not find the real kind of sales tax that we have been discussing today.

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Democracies Oppose Sales Tax Laws

Again (p. 74):

The proposition now is to take off one of those three chief categories—the tax on excess profits—and remove the burden from profits on wealth or income, and put it on the other or consumption side. This would, in my opinion, unduly shift the balance and bring us too near the position formerly occupied by all the aristocracies of old, and still reflected in some of the European countries. . . (p. 75): Why is it that England and America show their democracy, their real democracy, so much more than countries in the difficult position of Italy, or France, or Germany? There you will find throughout the war, and even now, the great mass of taxes imposed upon the consumption of the common man; whereas in England and in the United States during the Great War, as over against our experiences in the Civil War, the great majority of taxes are raised from wealth; that is, from those who can afford to pay, rather than from the consumption of the necessaries and comforts of life. . . After the United States, the two countries of the world which are making the most progress in fiscal reform are England and Italy—for Italy is doing better than France. When these two countries came to consider this problem they went into the question of a sales tax thoroughly and finally rejected it. On the other hand, the two big countries of the world that have adopted the sales tax, Germany and France, did so only as a last resort, after exhausting every other available source of taxation. . . Germany was forced to this sales tax in the last extremity, and in France the same is true. . . I have been in California for eight months, and had the pleasure some time ago of addressing a large body of business men in San Francisco assembled to discuss this question. I found that the situation was precisely that which was presented by our committee. Everyone was anxious to get rid of the profits tax, everyone had heard that here was a way out, and it captivated them all; every man in that room was in favor of a general sales tax. But after I had talked with them, not so much in opposition as trying to show that there was another side of the question which they must begin to study, it was marvelous to see what a change came over them; not because I spoke—because everyone would have done just as well—but simply because attention was now called to some of the less obvious aspects of the case.

A sales tax on the sales of capital would ruin New York City as the financial center of the country. A sales tax on the necessaries of life would evoke a political struggle the like of which we have never seen in this country (p. 77).

The sales tax represents an attempt to put an undue, an extravagant burden upon the consumer, instead of on the producer or the possessor of wealth. (p. 79).

Dr. Seligman discloses Messrs. Kahn, Bache, Rothschild, and others of like antecedents from the "aristocracies of old" favor a sales tax.

I will willingly leave my colleagues in Congress to say whose advice is to be considered. Shall it be that of a man whose judgment is not warped by personal or pecuniary interests, who handles the subject with the mind of a master, Seligman, whose opinion is supported by two great tax-investigating committees, by the experts of the Treasury, who have spoken through Secretary Houston, and by a dozen reputable witnesses quoted? Whom shall we follow in placing a billion-dollar tax on the backs of the people? Shall we accept these authorities or shall it be the wabbler and waverer banker and broker with

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his New York colleague, who spends eleven months a year, according to his own admission, in trying to dodge taxes? There can be but one answer.

Lest We Forget

A terrible war has swept over the world, leaving sorrow and misery strewn everywhere along the trail. The struggle with arms registered over a score of million men dead, wounded, or missing, but this was only one item of the losses. Social, industrial, and governmental upheavals have spread like à prairie fire from the war conflagration.

In our own land innumerable battles have been fought, as bitter and lasting in effect as those occurring over three thousand miles away. No statistics will ever record the broken homes, sicknesses, sacrifices, and deaths that have no place in history's battles nor of secret struggles when giving away millions of their best treasures—their boys. Nor will history ever properly record the taking of everything not nailed down during that war by profiteers who robbed the Government and robbed the public without limit or conscience. Scars are not yet healed, for the people have long memories.

Fortunes have been amassed and laid away that were wrung from the necessities of our Nation and of the people. That is only one chapter from the record, but that is a chapter with which we are now concerned because profiteering and pilfering of the public has been a continuous performance whenever opportunity exists, and it is brought forcibly to mind by the proposal and powerful propaganda to repeal the excess profits law and enact a general sales tax.

The Jobless Will Equally Pay a Sales Tax

In a report from the Department of Labor of January 26, just issued, the statement is made that 3,473,466 jobs have been lost within the past year and industry has been reduced approximately 40 per cent. In the face of this record Congress is now asked to exempt from taxation those who accumulated enormous profits in great corporate business and also to slash deep the surtaxes of those whose individual incomes reach high levels. According to Bache, who heads the sales-tax propagandists, these taxes now paid out of large profits and high incomes should be shifted on to the three and a half million jobless, who with their dependents must buy food, heat, and clothes,

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with an alternative, according to Bache, expressed with grim humor, "to merely refrain from consuming" (p. 58).

That advice is more cruel than Marie Antoinette's, "If they can't get bread, why not eat cake?" Bache has many disciples in this country and in the world today, but only the blind fail to see that an autocracy of wealth may become the handmaid of a military autocracy which the world has temporarily destroyed.

Those who try to view conditions without bitterness or prejudice find the greatest danger to our body politic today lies in the ruthless crushing of the individual, the cupidity and selfishness of men, and a modern-day arrogance of wealth, that in turn demands its protection from those whom it crushes.

In this day of world-wide commercial struggles, when the individual becomes swallowed up in the maelstrom, it is well to remember that under our form of government the humblest and poorest is entitled to equal rights of life, liberty, and the pursuit of happiness, unless it is to become a lost paragraph from our Constitution, and that next to liberty the most frequent cause for historic struggles has come from unjust taxation, with its accompanying oppression.

Other Tax Issues Not Discussed

I have presented what I believe to be facts and authorities that effectually discredit the present effort to saddle a turnover sales tax on the people of this country. One of the greatest campaigns for the tax is now being waged in Washington and throughout the country. The stakes are higher than with any legislative program in recent years because the plan proposes to shift the $800,000,000 to $1,000,000,000 in annual excess profits taxes over onto the under fellow.

Money is plentifully supplied to press this propaganda upon Congress. Every man who pays excess profits taxes in Congress will be pressed to join the movement, irrespective of economic, governmental, or political results. I have not sought to discuss the repeal of excess profits taxes nor the proper limit to place on personal income surtaxes. Nor have I assumed to discuss a constitutional amendment that will reach the hoarded wealth of Jules Semon Bache and others who invest their wealth in tax-exempt securities.

I have not presented the alternative of taxing capital now

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being pressed in other countries, notably England, and by large farming organizations and some labor organizations in our own country, nor have I dwelt on the fact that while England refuses to give up her excess profits tax and rejects a sales tax without any consideration, special interests most concerned here, following the example of the railway bill propaganda of last year, are straining every nerve to do here what England dare not do across the water, and I use the term "dare not" advisedly when referring to a turnover sales tax.

The Price Is Too Great to Pay

I have not discussed the political liability of a turnover consumption tax, nor have I indulged in useless predictions of what reward will be measured out to Representatives who listen to the siren song of the propagandists and fail to represent those back home those who will be called on to pay the bill—a billion-dollar tax bill—in addition to other taxes, local and Federal. These are all fruitful fields for discussion and may be covered before any turnover consumption tax is passed by Congress. I have tried to place before you the judgment of recognized experts, expressed both individually and through united action, all of whom condemn the passage of a general sales tax in this country in time of peace. Their views have not been given to Congress in any public hearings to my knowledge, although sales tax advocates led by an amateur expert who wabbles and wavers have been given full hearings by our committee with accompanying wide publicity through the press.

To my own mind the time is one of great concern. The future does not rest alone on the resumption of business but also on the willingness of men of large means to shoulder their full share of governmental and tax burdens. Temporary success of any sales tax measure will occasion loss of respect for property and of those who succeed.

The price is too great and one that even those drunk with power may well hesitate to pay.

BRIEF EXCERPTS

Any tax on what men have is better than a tax on what men need. *Tom L. Johnson. Congressional Record. 26:1652 January 30, 1894.*

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The [sales] tax, if shifted to the consumer, violates the fundamental law of equality of taxation. *Edwin R. A. Seligman. Proceedings of the Second National Industrial Tax Conference. p. 74.*

We collected in the last fiscal year something over $1,000,000,000 from consumption taxes, as I interpret the term "consumption taxes." That constituted about 2[illegible] per cent of the total internal tax budget. I think that it would be wrong to double that percentage. *Thomas S. Adams. Proceedings Second National Industrial Tax Conference. p. 111.*

No man that ever had anything to do with the marketing of farm products, whether as producer, seller, or buyer, would claim that the farmer could pass this tax on to the purchaser. The price of wheat is fixed usually by the Liverpool market. Liverpool will pay this price and no more, whether there is or is not a tax on the sale by the farmer. The price of corn is determined by the Chicago market. The corn grower is offered so much for his corn at the elevator. Of course, he can not pass that on. He will have to pay it. *William R. Green. Hearings before the Committee on Ways and Means. 1921. p. 86.*

Regarding the effects [of the sales tax] upon business, the testimony of a distinguished French scholar is worth citing. Gaston Jeze writes: "The tax is essentially a tax upon expenditures—the worst kind of tax for both producers and consumers At this very time it tends to increase the price in a formidable manner; in consequence, it helps to restrain consumption; it helps to close channels of sales at the moment when it is necessary to open new ones. In my opinion, the tax upon sales prices is responsible in large measure for the economic crisis which has now begun and bids fair to be long and terrible." *Nation. 112:683 May 11, 1921.*

The Wall Street Journal gives the following facts about the French turnover tax:

While estimated to produce as much as 460,000,000 francs in a month, the highest actual month's revenue from this source is 234,000,000 francs in September, while the lowest is recorded for March, 147,000,000 francs, against the estimated 415,000,000

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francs. In the concluding five months of last year, the tax having only come into practical operation last August, the yield was less than 1,000,000,000 francs instead of the expected 2,000,000,000. Moreover, during the eight months of its operation the yield has consistently declined. *Literary Digest. 69:70 May 7, 1921.*

The principal defect [of the sales tax] lies in the premium that such a tax would place upon synthesized business. The small business which confined itself to one branch of manufacture or sale and bought its stock from an independent business concern would be forced to charge higher prices than the large trust, which produced or mined its raw materials, transported them in its own ships to its factories, and finally sold the finished product through its own distributive agencies. And if we attempt to meet this fundamental objection by confining the tax to articles sold for "consumption and use," we meet an almost insoluble problem of classification. *Thomas S. Adams. Proceedings Twelfth Annual Conference National Tax Association. (1919) p. 312.*

It needs no argument to show that the standard of consumption inequitably distributes the burden. The millionaire, with his income of $50,000 a year, cannot eat or wear a hundred times as much as the day laborer with his income of $500 a year. Nor in the ordinary course of events does he spend a hundred times as much on travel, horses, furniture, or any of the other luxuries of life. Taking the country through, it is safe to say that expenditure does not increase in proportion to property or income. The conclusion is inevitable that the poorer a man is, the larger his proportionate share of the burden of taxation; whereas, if there were to be any inequality whatever, the richer a man, the larger relatively should be his share. *Robert Luce. Public Opinion. 13:51 April 23, 1892.*

To those who are not unacquainted with the ways of financial interests, the mere fact that the proposition [the increase of the rate of sales tax] emanates from their councils is enough to provoke suspicion, and when it is affirmed that the tax is "passed along in small fractions and is finally paid by the consumer, practically without his knowledge, and the additions are so trif-

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ling as not materially to affect prices," that such a tax would raise more revenue than the country actually needs, and that its adoption would lead to repeal of the excess profits tax and the income tax, one begins to detect the "nigger in the wood-pile." It takes a wizard of finance to maintain that some $500,000,000 a year can be painlessly extracted from the people of Canada. *Winnipeg Grain Growers' Guide.*

An effort is being made by those who represent "Big Business" to shift the burden of taxes from the profiteers to the masses. First, they demand the repeal of the excess profits tax and the substitution of other taxes that burden all. The excess profits tax is the most just tax there is—it is collected from those who collect excess profits—that is, larger profits than they should. It is the only tax that a taxpayer can avoid by his own act—let him stop stealing and he will not have to divide with the government. And yet this is the one tax that the reactionaries want repealed. The next demand is for the lowering of taxes on big income and an increase in the rate on smaller incomes—as bold a piece of piracy as was ever proposed. *William J. Bryan, Commoner. 21:1 August, 1921.*

Those who defend the equity of the sales tax under the assumption that it will be completely shifted, must attempt to demonstrate that the gross expenditure is a more exact and satisfactory standard of ability to pay than net income. This is a hopeless task. A standard of gross expenditure would relieve savings from all taxes. Our greatest savers are the richest classes. But not only would the sales tax apply to a much larger share of the small man's income than of the rich man's, but the tax would also fall just as heavily on the small man's dollar as on the rich man's. This will not appeal strongly to those who believe in the equity of progressive taxation. Indeed, the sales tax is grossly unfair to the poor man, and should be dropped for that reason alone. *Nation. 112:683 May 11, 1921.*

The sales tax, in any form proposed, whether a turnover tax or a tax on retail sales only, violates the cardinal principle of ability to pay. The tax would be paid by the bankrupt as well as by the individual or corporation with a net income. Such a tax would retard the movement of stocks put in at

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higher prices, and hence is peculiarly unfitted to the present industrial situation. It would be unjust as between competitors in the same industry depending on the degree of integration in the various industries. It would be particularly odious and heavy in those industries where the turnover would be rapid in proportion to capital invested. More important still, it is an indirect tax, to a certain extent, and if adopted would abide with us to an extent that a direct tax would not. The direct tax has the distinct advantage of making those who pay it watchful of governmental expenditures and governmental efficiency. *Clyde L. King. Annals of the American Academy 97:72. Sept. 1921.*

Further consideration of the subject has convinced me that a general sales or turnover tax is altogether inexpedient. It would apply not only to the absolute necessities of life—the food and clothing of the very poor—but it would similarly raise the prices of the materials and equipment used in agriculture and manufactures. It would confer, in effect, a substantial bounty upon large corporate combinations and trusts and place at corresponding disadvantage the smaller or disassociated industries which carry on separately the business operations that in many combinations and trusts are united under one ownership. The group of independent producers would pay several taxes, the combination only one tax. Finally, it would add a heavy administrative load to the Bureau of Internal Revenue which—burdened as it is with the responsibility of enforcing the child-labor tax law, the national prohibition act, the narcotic-drug law, the adulterated butter and mixed-flour tax laws—is already near the limit of its capacity. *Secretary David F. Houston. Review of Reviews.*

It cannot be questioned that ability to pay is the only just and practicable basis for the apportionment of taxes, or that this ability increases with increasing income at a rate more rapid than the increase of the income itself. Nor can it be doubted that, although a social reform cannot be effected through any conceivable use of taxing machinery, yet the conditions under which a more healthful social evolution can take place than is observed at the present time may result from the manner in which the taxing machinery is employed. This, as well as the idea of equity, induces the mind to consent to the principle of

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progression. It may further be conceded that the fear entertained by English economists lest the accumulation of capital and the development of industry should be arrested by progressive taxation is not warranted by the facts in the case; but, on the other hand, that the principle of progression judiciously applied will tend to invite experimentation and give an opportunity to energy under conditions likely to be the most conducive to industrial and social development. Each of these arguments considered by itself seems to warrant confidence in the theory of progressive taxation. *Henry C. Adams. The Science of Finance. p. 352.*

A still more important objection to indirect taxation is that when imposed on articles of general use (and it is only from such articles that large revenues can be had) it bears with far greater weight on the poor than on the rich. Since such taxation falls on people not according to what they have, but according to what they consume, it is heaviest on those whose consumption is largest in proportion to their means. As much sugar is needed to sweeten a cup of tea for a working girl as for the richest lady in the land, but the proportion of their means which a tax on sugar compels each to contribute to the government is in the case of the one much greater than in the case of the other. So it is with all taxes that increase the cost of articles of general consumption. They bear far more heavily on married men than on bachelors; on those who have children than on those who have none; on those barely able to support their families than on those whose incomes leave them a large surplus. If the millionaire chooses to live closely he need pay no more of these indirect taxes than the mechanic. I have known at least two millionaires—possessed not of one, but of from six to ten millions each—who paid little more of such taxes than ordinary day laborers. *Henry George, Protection or Free Trade, p. 78-9.*

Ought what a person consumes to determine the portion that he should contribute to the support of the government? This theory, which is one of the oldest in economic history, an able writer states as follows: "Every man ought to be taxed on all that property which he consumes or appropriates to his exclusive use." In opposition to this view it may be said, in the first place, that it is economically impossible for the government to take

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anything for its support from a man who does not earn the bare necessities of life. To attempt to do so would result only in failure. For what the State took away from such a man with one hand as a taxpayer it must return to him with the other as a pauper.

In the second place, on what ethical ground should we exempt men from paying a tax on that portion of their wealth that they do not consume? It is from what they have left after supplying the necessities of life that they are most able to contribute to the expenses of the government. The first maxim of a just system of taxation, that a person should contribute to the public revenue according to his ability, is plainly violated by such an exemption. The man with millions and few personal expenses might often by this arrangement contribute less to the support of the government than a day laborer with a large family who possessed almost nothing.

It can hardly be doubted that our national taxes upon salt, coal, clothing, and the materials used in the construction of dwellings, violate the very first principles of justice and economics. They enhance the cost of mere subsistence, and any act of the government that does that is oppressive and unjust. They are as another expresses it, "a veiled or disguised tax on the wages of labor," and pre-eminently injurious to the welfare of the very classes they profess to benefit. Just as the property system of taxation oppresses the farmer and compels him to contribute far more than his due share to the public revenues, so the expenditure system, or a tax on consumption, oppresses the working classes, obliging them to pay not only their own taxes but a large proportion of the taxes of others. *Frank S. Hoffman. The Sphere of the State. p. 120-1.*

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PART III
THE STATE INCOME TAX

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BRIEF

RESOLVED: *That this state should adopt a state income tax, similar to that in vogue in Wisconsin or New York.*

AFFIRMATIVE

INTRODUCTION:

- A. Meaning of the question.
  - 1. The income tax as a state measure.
  - 2. The revenue may be partly or largely returned to the cities and other local governments.
- B. Importance of the question.

I. Our state and local governments are in need of more revenue.

- A. Modern progress requires that they have much more funds.
  - 1. To build and maintain good roads which have now become a necessity.
  - 2. To build, equip and operate good modern schools, in the rural districts and small towns, as well as in the larger cities.
  - 3. To provide proper public health service.
  - 4. To provide adequate play ground facilities for the children and recreation facilities for adults.
  - 5. To pay adequate salaries to public school teachers.
- B. In many states the cities are in dire need.
  - 1. The schools in New York City have been endangered.
  - 2. Several of the cities in Ohio have been compelled to borrow money to meet current operating expenses, short time notes being issued that were in some cases later refunded into long time interest-bearing bonds.

II. Other forms of taxation have failed to yield the necessary revenue or are unsuited to the purpose.

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A. The general property tax is everywhere an unquestioned failure.
   1. Much personal property, often two-thirds of it, is not even listed for taxation.
      a. This punishes honesty and rewards dishonesty.
      b. It puts an unjust and unfair burden upon the owners of real estate and other tangible property.
   2. Most property is greatly undervalued for the purpose of taxation, often as low as one-third of its true value.
      a. This is very unfair and unjust, because some forms of property are assessed at their full value, while others are lower than the average basis.
         (1) The property of widows and orphans is assessed at its full value.
         (2) The property of large corporations is assessed far lower than the homes of the poorer people.
   3. It is easily evaded by the richer people and the great corporations.
      a. Tax-dodgers often have their residence just outside of a large city or just across a state line.
      b. People determined to evade their honest share of taxation will often organize a suburban city or village and resist annexation, so as to have all the benefits of a great city without helping to pay for them. Almost every large city in America has one or more of these "satellite and parasite" communities. Sometimes the city has grown and completely surrounded the tax-dodgers' nest.
      c. Large corporations will often have their "main" office in some small town where taxes are low, or where they can control the officials.
      d. The property of the poor is of such kind as is difficult to conceal or undervalue, while the opposite is true of the property of the rich.

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4. It often results in double taxation.
   a. In some states land worth $10,000 is taxed at its full value, and a mortgage of $5,000 is taxed at its face value.
5. It taxes all property at the same rate, which is unfair and unjust.
   a. All property is not equally productive.

B. Corporation taxes cannot be raised in most states.
1. Corporations pay taxes upon their property under the general property tax.
2. In most states they are called upon to pay special taxes, such as fees, licenses, franchise taxes, capital stock taxes or some similar special tax.

C. The federal government has enacted an inheritance tax.
1. The federal tax sums up to 25 per cent.
2. Any additional tax would be an unfair and unjust burden.

D. The poll tax is unjust and unprofitable.

III. A state income tax, similar to the one adopted in Wisconsin or New York, is desirable.
A. It is certain in its yield.
B. It is just and equitable—it taxes people in proportion to their ability to pay.
C. It is easy to collect.
D. It is difficult to evade.
E. It is impossible to shift it.

IV. A state income tax is practicable.
A. It has been successfully employed in many places.
1. It has been long used in several other countries.
2. It has been employed in many states of our union.
3. It has recently been remarkably successful in Wisconsin, Massachusetts, New York, and some other states.

B. A state income tax does not interfere with the federal income tax.
1. None of the thirteen states that have a state income tax have noticed any difficulty or interference because of the federal tax.
2. All taxes must be paid out of income.

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3. The federal government now cooperates with the states to decrease the cost of collection and prevent evasion.

Negative

Introduction:

A. The negative does not deny the merits of the income tax as a federal measure, but we do deny that any success of the income tax as a federal measure will prove it would be equally successful as a state system.

B. We must judge its worth by its history in the different states as a state measure.

I. The income tax is a source of revenue that should be left to the federal government.

A. Our entire scheme of taxation must be readjusted to meet the conditions that the World War has produced.

1. The federal government is now in dire need of more revenue.
2. For several generations to come the national war debt will require greatly increased income for the federal government.

B. There should be complete cooperation and harmony between the states and the federal government in the matter of taxation.

1. No state can be justified in taking a course that will annoy or embarrass the national government.

C. Nation-wide uniformity in the rate of income taxation is best.

1. It will decrease the uncertainty which is a serious interference with industry.
2. It will prevent duplication of the tax machinery.

II. State income taxes have many objectionable features and results.

A. A state income tax is easily evaded by the richer people.

1. A person can take up a residence across a state line.
2. Corporations can reincorporate in another state.

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3. No state can compel a corporation, incorporated in another state though doing business within its limits, to reveal the stock or bond holdings or the dividends received, by one of its own citizens.
    a. It is therefore impossible for a state to employ the principle of stoppage at source in collecting its state income tax.

B. It puts a premium upon falsehood and evasion, which has the effect of a handicap upon honesty.
    1. In the keen competition of the business world, the rascals are helped to survive by state income taxes.

C. It is particularly unwise for any state to tax the citizens of other states, as is done by the income tax law of New York and several other states.
    1. It has always been the law that personal property shall be taxed according to the domicile of the owner.
    2. It violates the principle of no taxation without representation.
    3. It creates and develops bad feeling among the states and will lead inevitably to retaliatory measures.
    4. If all states adopt this provision, it will mean universal double taxation, with frequent triple and quadruple taxation.

III. The income tax is impracticable as a state measure.

A. The experience of our states with the income tax shows that it has failed in most of the cases where it has been tried.
    1. It has failed in all of the states where it has been in effect for any considerable number of years.
    2. The states in which it is claimed to be a great success are the ones where it has only recently been adopted.

B. What our states and cities need is not more revenue, but more efficiency, economy, and honesty in their administrative service.

C. The adoption of a state income tax does not mean the repeal of the general property tax.

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1. Wisconsin in 1919 raised about ten times as much revenue from its general property tax as it did from its income tax.
2. Most of the state commissions that have recommended the adoption of the income tax have stated that it was to supplement the general property tax, not to supplant it.

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INTRODUCTION

In the best literature of taxation during the last decade of the nineteenth century and the first decade of the twentieth century, both in the reports of tax officials and tax commissions and in the writings of the recognized authorities on taxation, the preponderance of opinion was strongly against the income tax as a state measure. At the beginning of the third decade of the twentieth century the majority of the best that was said and written on the subject was in favor of such a tax. Moreover, several of the ablest authorities on taxation were opposed to the state income tax twenty years ago while the very same men are in favor of it now. Newspaper editorials and magazine articles have, for the most, followed and accepted this marked change in public opinion.

There are two reasons for this complete change of attitude toward the state income tax: first, that no state had made a real success of its income tax until 1911 when Wisconsin enacted the first efficient law of the kind; and second, that the recent and constantly increasing need of the state and local governments for more revenue has made legislatures seek new forms of taxation.

The state income tax is not a new and untried thing. Back in the colonial days, as early as the middle of the seventeenth century there were faculty taxes. The authorities are divided as to whether these faculty taxes were income taxes or not. Since the adoption of the federal constitution about one-half of the states have had an income tax at one time or another. At the present time about one-fourth of the states have such a tax. Several of these have adopted it within the last few years, that is, since the Wisconsin tax was adopted. In several other states there has been strong agitation for its adoption.

The earlier state income taxes were unquestioned failures, due to inefficient administration. In several of the states the older income tax is still in vogue, and is still a complete failure. In Wisconsin, Massachusetts, New York and some other states

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where the newer ideas have been employed, the state income tax is an unquestioned success.

That the general property tax is everywhere a failure is the almost unanimous testimony of all who have written upon the subject. It is unfair, unjust, easily evaded, burdensome, and not sufficiently productive. At the same time the need for more revenue is constantly growing. States, cities, villages, towns, counties, and townships all over the country find their expenses growing at a rapid rate and their needs growing even faster. Modern progress makes each community demand more of its local government. Better roads, better schools, reasonable salaries for teachers and others, adequate public health service, playgrounds, food inspection, and many other similar services are things which the citizens of every community are now demanding of their local governments. To get the funds to do these things is a serious problem. It is under these conditions that officials and scholars are turning to the state income tax.

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GENERAL DISCUSSION

THE FAILURE OF THE PERSONAL PROPERTY TAX[1]

History of Tax in Europe

We would like, did space permit, to trace the history of the personal property tax from mediæval times down to the present day; to show how it was once in use in practically every country in Europe; how, as the earlier and simple economic structure gave way to modern complex development, its weakness and defects became apparent, so that one by one these countries abandoned it until today Switzerland is the only country in Europe where the general property tax still remains. We cannot do better in this connection than to quote briefly from Seligman's Essays on Taxation, page 61:

> Historically, the property tax was once well-nigh universal. Far from being an original idea which the Americans instinctively adopted, it is found in all early societies whose economic conditions were similar to those of the American colonies. It was the first crude attempt to attain a semblance of equity, and it at first responded roughly to the demands of democratic justice. In a community mainly agricultural, the property tax was not unsuited to the social conditions. But as soon as commercial and industrial considerations came to the foreground in national or municipal life, the property tax decayed, became a shadow of its former self and, while professing to be a tax on all property, ultimately turned into a tax on real property. The disparity between facts and appearances, between practice and theory, almost everywhere became so evident and engendered such misery, that the property tax was gradually relegated to a subordinate position in the fiscal system, and was at last completely abolished. All attempts to stem the current and to prolong the tax by a more stringent administration had no effect but that of injurious reaction on the *morale* of the community. America is today the only great nation deaf to the warnings of history. But it is fast nearing the stage where it, too, will have to submit to the inevitable.

Failure in the United States

The personal property tax has had a fair trial in nearly every State in the Union, and has everywhere proved a failure. This is the practically unanimous verdict of the many able commissions that have made a careful study of the tax in the various

[1] Report of the Joint Legislative Committee on Taxation of the State of New York. 1914. p. 31-54.

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states. To quote from all of these reports, however impressive the evidence would be, would be merely cumulative. We give therefore, but brief extracts from five of the most important, which may fairly be said to be typical and representative.

Report of the Commission on Taxation, Massachusetts, 1908, Pages 22-24, 25, 26-28, 33-34

This method of taxation is frequently described as peculiarly American and democratic, and it is supposed to be a method which, if fully carried out, would oblige every man to contribute to the support of public charges in proportion to his ability to pay. But, as a matter of fact, the system is neither distinctively American nor democratic, and it is admitted that, however excellent the intent of the law, the practical result has never been that all citizens do contribute in proportion to their ability to bear the charges of government.

The general property tax was once in nearly universal use in Europe, and was brought to Massachusetts by the early settlers, who merely introduced here a system with which they had been familiar in the country from which they came. In England, as in most other countries of Europe, the principal form of direct taxation had long been a general levy upon property. In the seventeenth century this tax was known as the subsidy, and in practical operation produced the same results as followed its introduction in the New World. Personal property always managed to escape taxation in whole or in part, so that complaints about the inequality and injustice of the system were almost as common as they are in Massachusetts in our own time. In 1592 one writer stated that not more than five men in London were assessed upon goods exceeding £200, and in 1601 Sir Walter Raleigh complained that "The poor man pays as much as the rich." About the middle of the seventeenth century the subsidy became so unsatisfactory that it was replaced by a new tax, known as the monthly assessment, which was, however, but the same thing under another name. The immediate result of the change was a somewhat more complete assessment of property; but before long personalty began to evade taxation as before; so that in 1692 the monthly assessment was abolished, and replaced by a new tax designed to reach the true yearly value of all lands, tenements, offices and personal estates. This

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new tax was but another property tax in a somewhat different form, and it soon fared as badly as its predecessors. During the eighteenth century personal property disappeared from the assessment rolls as rapidly as ever before, so that by 1798 over nine-tenths of the levy fell upon real estate, and less than one-tenth upon offices and personal estate. By this time, in fact, the tax had generally come to be known as the "land tax." In some towns, we are told, the whole tax was assessed upon land and houses and personal estates wholly escaped.

In 1798 an act was passed by which the land tax became virtually a fixed charge upon the land, and since that time no further attempt has been made in England to levy a general property tax. The national revenues are now derived from an income tax, taxes on inheritances and the usual indirect taxes; while local revenues are drawn chiefly from a tax levied upon occupiers of land, houses and trade premises.

And in most of the other countries of Europe the result has been the same. . .

It is equally erroneous to call the general property tax a democratic form of taxation. It is not found in such ultra-democratic communities as the Australasian States; nor, with the exception of Switzerland, is it found in those countries of Europe in which democratic ideas have taken deepest root. It was brought to America from England in the seventeenth century, when democracy existed neither in the mother country nor the colonies, and has been fastened upon us rather by historical accident than because of its inherently democratic qualities. . .

The history of the general property tax in Massachusetts is not materially different from its history in other states. From 1651 to the present date complaints that personal property evades taxation are met at every hand. During the last thirty-five years four commissions or special committees, exclusive of the present, have been appointed to study the question; and their reports disclose the fact that the taxation of intangible property is the weakest point in the entire system. There is reason to believe that the administration of the law by Massachusetts assessors has been considerably better than the administration of the laws of many other states. The taxation of intangible property has not been such a complete farce with us as it has been elsewhere; yet we find no one who supposes that we are now taxing more

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than 10 or 20 per cent of the money, credits and securities taxable under our present law. After careful study of the subject, our commission is forced to the same conclusion that was reached by the commission of 1897, which we reproduce here:

> It is obvious, however, that this method of taxation encounters, as to intangible property, exceptional and indeed almost insuperable difficulties. There are no such external indications of taxable liability as appear in the case of live stock, vessels, stock in trade or machinery. General repute as to the possession of large means, or a mode of life indicating an ample income, do not necessarily signify anything as to taxable securities. The investments of a person of means may be in real estate within or without the State, or in Massachusetts stocks or mortgages, or in bonds of the United States. An ample income, indicated by general expenditure, may be derived either from such sources already taxed or not taxable, or from trade and profession, or from taxable securities,—these last two being taxable, but taxable at very different rates. The assessors hence must rely on their knowledge and judgment in estimating the taxable property of this form. In a great and complicated society, with a mass of investments ramifying in all directions the assessors are here confronted with a task which the best of them could not execute satisfactorily. Even the most capable, most experienced and most conscientious assessors could not have sufficient knowledge and judgment. But only average capacity can be expected; experience is often lacking; and, even for conscientious assessors, the temptations to laxity are in many cases irresistible. Consequently, the taxation of this form of property is in high degree uncertain, irregular and unsatisfactory. It rests mainly on guess-work; it is blind, and therefore unequal. Here is its greatest evil, though not its only evil. It is haphazard in its practical working, and hence demoralizing alike to taxpayers and to tax officials.

Report of Maryland Commission, 1888, Pages 101, 103, 151

The truth is, the existing system is so radically bad, that the more you improve it the worse it becomes. This lies in the nature of things and nothing any Legislature can do can alter this condition of things. Experience and reason alike teach this, and in my opinion place it beyond controversy for all those who have eyes to see what is passing about them every day of their lives.

The reason why our present system of taxation does not operate satisfactorily can be stated in a word; although it is on the face of it fair and simple, it is found in practice to be an impracticable theory, for a large portion of property escapes taxation, and that the property of those best able to bear the burdens of government, namely, the wealthy residents of cities. On the one hand, it is impossible to find this property, and to force men to make returns under oath, results invariably in perjury and demoralization, without discovery of property; on the other hand, federal laws over which our States and municipalities have no control, enable many to escape taxation by investments, often temporary, in federal bonds, exempt from taxation.

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Personal property is sometimes discovered in its entirety, but it is then nearly always the property of the comparatively helpless, namely, widows and orphans, whose possessions are a matter of public record. Less often a burden is imposed upon the conscientious. Thus, I happen to know of one wealthy town of a few thousand inhabitants, where three men of conscientious convictions with regard to a man's duty to the commonwealth, pay taxes on their personalty, although they have as good an opportunity to escape as others. This state of things naturally produces dissatisfaction on the part of farmers and other hard working people, who feel that personalty ought to bear a share of the burden of taxation. On this account they suggest various things, like taxation of mortgages, and a more vigorous search for hidden property. Their aim, as I have said, is commendable, but to attempt to reach the desired goal by direct means, under existing laws, or any laws which do not imply a change of the system of taxation, is as utopian as the dream of the most radical socialist. If we desire to accomplish a purpose we must use means adequate to the end in view. . .

Another aspect of this case is presented by the facts of competition in business. Those who escape the payment of a fair share of business taxes have an advantage in business which enables them to undersell their competitors, and when a business man sees ruin staring him in the face because his dishonest neighbor makes false returns and pays taxes on only a fractional part of his property, the temptation to do likewise is almost irresistible, except for moral heroes, and moral heroism cannot be made the basis of governmental action.

Report of Kentucky Special Commission, 1912, Pages 83-4

In 1904 the total roll was $630,795,464, and monies, credits and securities were assessed at $68,829,446, or 10.9 per cent.

In 1911 the total roll was $846,450,020, and monies, credits and securities were assessed at $83,468,030, or 9.8 per cent.

In 1906 the ratio was 10.8 per cent.

In 1907 the ratio was 11.5 per cent.

In 1908 the ratio was 10.1 per cent.

In 1910 the ratio was 9.5 per cent.

As we said in our preliminary report: ***The state of Kentucky received more revenue for the year 1912 from its dogs than it did from all the bonds, monies and stocks in the state.***

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When finally we note that money, credits and securities taxed in 1910, the year of the census, were $79,000,000 or only $34 per capita, the necessity for further research seems to disappear.

Nobody can seriously maintain that *all* monies, credits and securities are taxed or any substantial part.

In the opinion of the Commission, the present methods of taxing money and credits are ineffective in producing revenue and highly unjust in their operation on individual taxpayers. They constitute one of the gravest problems connected with our system of taxation, and until they are changed our tax laws will remain vitally and fundamentally defective.

Report of Virginia Tax Commission, 1911, Pages 69-70

To summarize, it has appeared that inequalities and under-valuations of every sort appear in our taxation of personal property. How extensive these are can only be surmised; how iniquitous they are can merely be imagined. Viewing the situation as a whole, the writer believes that it would be better to remove the tax on personal property altogether and seek other sources of revenue, than to perpetuate the frauds, inequalities and under-valuations which now encumber the administration of our tax laws.

A law which permits these things is unquestionably a failure, and it behooves those interested in the problem to ascertain why and wherein the law has broken down. Examination has shown that the failure of the property tax in Virginia may be traced to four things. These are, first, the attempted enforcement of a law under industrial conditions which render it inoperative of necessity and invalidate the theory upon which it is based; second, the failure of many commissioners of the revenue to enforce the existing laws; third, certain defects in the law which make deceit and injustice easy; fourth, the growth of a feeling among our people that there is nothing dishonorable or discreditable in "dodging taxes."

Report of National Tax Association, Vol. IV, Pages 309-10

To sum up, your committee finds:

That the general property tax system has broken down;

That it has not been more successful under strict administration than where the administration is lax;

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That in the states where its administration has been the most stringent, the tendency of public opinion and legislation is not toward still more stringent administration, but toward a modification of the system;

That the same tendency is evident in the states where the administration has been more lax;

That the states which have modified or abandoned the general property tax show no intention of returning to it;

That in the states where the general property tax is required by constitutional provisions, there is a growing demand for the repeal of such provisions.

We conclude, therefore, that the failure of the general property tax is due to the inherent defects of the theory;

That even measurably fair and effective administration is unattainable; and that all attempts to strengthen such administration serve simply to accentuate and to prolong the inequalities and unjust operation of the system.

Summary of Reports of New York Commissions

The New York authorities are all to the same effect.

A more unequal, unjust, and partial system for taxation could not well be devised. (First Annual Report of the State Assessors, 1860, p. 12.)

The defects of our system are too glaring and operate too oppressively to be longer tolerated. (Comptroller's Report, 1859.)

The burdens are so heavy and inequalities so gross as almost to paralyze and dishearten the people. (Assessor's Report, 1873, p. 3.)

The absolute inefficiency of the old rickety statutes passed in a bygone generation is patent to all. (Assessor's Report, 1877, p. 5.)

The hope of obtaining satisfactory results from the present broken, shattered, leaky laws, is vain. (Report Association of Taxes and Assessments, 1876, p. 52.)

The system is a farce, sham, humbug. (Assessor's Report 1879, p. 23.)

The present result is a travesty upon our taxing system, which aims to be equal and just. (Comptroller's Report, 1889, p. 34.)

The general property tax is a reproach to the state, an outrage upon the people, a disgrace to the civilization of the nineteenth century, and worthy only of an age of mental and moral

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darkness and degradation when the only equal rights were those of the equal robber. (Comptroller's Report, 1889, p. 34.) The above quotations from the New York reports are taken from Seligman's Essays in Taxation.

Report of 1872

The report of the Commission of 1872, of which Mr. David A. Wells was chairman, was one of the ablest tax reports ever written. We, therefore, quote from it at some length:

> In the case of New York, no one, either officials or citizens, is satisfied with the existing system or its administration; and so apparent, moreover, are its defects, that the necessity of reform is almost universally acknowledged. But the Commissioners who have made the system a matter of special study and inquiry, go further, and unqualifiedly assert that, as it exists today it is more imperfect in theory and defective in administration than almost any system that has ever existed, and that its longer recognition and continuance is alike prejudicial to the material interest of the state and the morality of its people.
>
> Real property being visible and tangible, presents no inherent difficulty in the way of assessment, and the system might be reasonably supposed to work with some degree of uniformity and equality, yet they found it impossible to find any two contiguous towns, cities or counties in which the valuation of real estate approximates in any degree to uniformity.
>
> It is evident that the law in this respect has become a dead letter and wholly inoperative. The attempts to tax *personal property* under the same system are infinitely more farcical and disgraceful.

The reasons for the failure are as follows:

> In the first place, a large part of personal property "is incorporeal and invisible, easy of transfer and concealment, not admitting of valuation by comparison with any common standard, and the situs or locality of which for purposes of assessment and taxation, involves some of the oldest, most controverted and yet unsettled questions of law. . . It is obvious, therefore, that the law contemplates the doing of an act . . . which cannot be done without the fullest cooperation through communication of information of the taxpayer himself; and yet for the imparting of which the two most powerful influences that can control human action, viz., love of gain and the desire to avoid publicity in respect to one's private affairs, cooperate to oppose."

Report of 1893

The taxation of personal property is "unsatisfactory and unjust, and if no better plan of administration be devised and carried into effect than that now in existence, it is idle and worse than useless to attempt the taxation of personalty, however objectionable the alternative." (Report of Counsel to Revise the Tax Laws of the state of New York, 1893.)

Report of 1900

The Joint Committee on Taxation for the year 1900 likewise found that the personal property tax was a failure, and did not believe any reform would remedy the situation unless the listing

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system were adopted. This, however, the committee was unwilling to recommend. It found that while the first returns were apparently good under the listing system, it eventually drove capital out of the state.

Report of 1907

The principal difficulty connected with our system of local revenue is the taxation of personal property. . . It is a universally accepted maxim that direct taxation of the citizen should be as nearly as possible in proportion to his ability to pay. The actual situation in New York involves in practice the very inverse of this principle.

As a result of its study the committee concluded:

1. That there has been gradual and steady increase in the value of real and personal property;

2. That personal property escapes paying its share of the burden;

3. That the greater the amount of personal property placed on the rolls, the larger the cancellations or reductions;

4. That the burden falls heaviest on the residents of our state and the smaller taxpayer:

5. That the non-residents have almost ceased to pay taxes;

6. That the collection of the personal property tax has become more and more difficult.

Causes of the Failure of the Personal Property Tax

Briefly stated, the objections to the personal property tax and the reasons for its failure are as follows:

1. Inequality of assessments.

a. As between towns. It is notorious, and the facts to be submitted later will show beyond question, that in some towns personal property is assessed at something like true values, whereas in others no attempt whatsoever is made to reach the personal property of either corporations or individuals, or if it is reached, it is assessed at a value insignificant as compared with true value. This has a tendency to produce throughout the state "isles of safety" or residential districts desirable from a tax standpoint for both individuals and corporations who, by establishing a nominal residence, and by the payment of a small or nominal tax, in one town, are enabled to escape their proportion of the taxes in the town in which they actually reside. Thus, the one town is enabled to increase its tax base and lower

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its rate, while the other is deprived of large amounts of taxable property and is obliged to tax that which remains within its jurisdiction at a higher rate.

b. As between citizens of the same town. The system is practically one of self-assessment, under which the dishonest man who is willing to swear off his taxes, does so at the expense of the honest man whose conscience does not permit him to do so.

2. The personal property tax at a general property rate, let us say 2 per cent, is confiscatory and an actual incentive to dishonesty. Two per cent is the equivalent of 50 per cent of the income of a 4 per cent bond, and no country in the world in normal times has or can successfully impose a 50 per cent income tax. The taxpayer will not submit to it, particularly when he knows that thousands of fellow citizens, in many cases with incomes much larger than his own, are actually evading its payment.

3. The theory underlying the general property tax is that both real and personal property should be taxed at the same rate and on the same basis. Without at this time discussing the soundness of this particular theory, as a matter of practice, real estate bears practically the entire burden, while personal property, though theoretically liable, fails to contribute its share to the support of government.

4. The deduction of debts invites fraud and evasion, yet not to allow deduction of debts is in some cases double taxation. As has been said, "Individuals should be taxed on what they own, not on what they owe." This, of course, is not true in the case of many corporations that obtain most of their working capital by issuing bonds.

5. The personal property tax is unequal as between different grades of property. It falls with equal weight upon unproductive property, on property yielding comparatively small income, and on property bringing in a very large return.

6. Under modern conditions, property no longer represents the true test of ability to pay. In a simple agricultural community, where personalty is for the most part tangible and visible, property furnishes a fairly equal measure of a man's ability to contribute to the support of government; but under modern business development this is by no means the case. Take the case of the merchant with a large turnover and a com-

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paratively low profit. His ability to pay taxes is by no means the equal of that of the merchant with a small stock of goods, a rapid turnover and large profits; yet under the personal property tax the former rather than the latter will pay the larger tax. Take the case of the manufacturer. The one may own a very large plant with complicated, expensive machinery, and the necessities of his business may require him to carry a large inventory. He may earn but a small return on his investment. Another manufacturer in another line may have a smaller plant, much less valuable machinery, a comparatively light inventory, and yet because of the nature of his business may have a greater income. Here again the ability of the latter to contribute is greater than that of the former, yet the former under the personal property tax pays the heavier share. As between individuals, the lawyer earning $50,000 a year pays nothing on the taxable ability represented by these large earnings, while the widow or the retired business man or wage-earner with $500 a year derived from accumulated savings of $10,000 is compelled to turn over $200 of it to the tax gatherer. The investor who makes an unwise investment from which he gets little or no return pays as much as the fortunate individual enjoying fat dividends; the man with a large unearned income and extravagant habits gets off scotfree, while the thrifty one who in spite of a lower earning capacity and less ability to pay taxes manages to lay something aside is taxed on the evidences of his thrift.

7. Personal property under modern conditions consists for the most part of securities, credits and other intangibles, easy of concealment and which cannot be discovered without the cooperation of the taxpayer himself—a cooperation which the taxpayer declines to furnish, and which experience has demonstrated cannot be compelled. Moreover, the large accumulations of wealth in form of intangibles are usually concentrated in the great cities under conditions which make it well-nigh impossible for the assessors to locate the owners—a complete change from the conditions under which the personal property tax was adopted, when life was simple, wealth fairly equally distributed, when people lived in villages or small towns, and when each man knew not only what his neighbor owned, but what property of his was assessed. Even in so far as tangible personalty is concerned, consider the difficulty which confronts the average assessor who may be required to assess accurately anything from

a Rembrandt picture to a large modern industrial plant. The fact is that, at the wages paid—which in many instances do not exceed $3 a day—it is impossible to obtain any man with a sufficient accumulation of knowledge to enable him to deal successfully with a field so wide as to include within its range practically every form of property found in a complicated society.

8. The great number of exempt securities makes it possible for the wise investor lawfully to escape personal property taxation, leaving the tax to fall on those not sufficiently fortunately situated to obtain wise legal advice and on those ignorant of the law.

Injustice of the Personal Property Tax

All semblance of justice and equity has long since left the personal property tax, which has been suffered to remain on our statute books because of the widespread apathy and ignorance of the public in regard to taxation, and because of the fact that it has not, generally speaking, been enforced.

1. As between tangible and intangible personalty. Tangible property can be seen; intangible property cannot be seen. Tax assessors find it comparatively easy, therefore, to discover tangible property, while they have the greatest difficulty in locating intangible property. Everywhere the result is the same—not only is a much larger proportion of tangible property reached for the purposes of taxation, but that proportion reached bears a much higher rate of taxation as a result of the escape of intangibles.

The inequity is further accentuated by the fact that those most able to pay have their wealth largely invested in intangibles and that those least able to pay have their wealth largely invested in tangibles. The magnitude of this injustice will appear as we examine the effect of this tax upon the rich as compared to the poor, upon the widows and orphans, upon the farmers as compared with owners of other forms of wealth and upon the struggling business as compared to the well-established business. In every case the inequity increases with the inability of the particular classes to bear taxes.

2. As between the poor and the wealthy. Not only do the poor and those in only moderate circumstances have their wealth invested in easily seen and easily taxed tangibles, but the kind of tangible personalty in which the poor man invests his money,

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whether it be in his household effects or in his small business, is of such nature that the ordinary tax assessor is familiar with it and can therefore assess at well-nigh its true value. This is true as well of the tangible personalty that makes up the small business concern as of the tangible personalty included in the household goods and other personal effects. In the case of the wealthy man, however, the case is a very different one. Not only is a large part of his wealth ordinarily invested in intangibles, but much of his tangible personalty, whether that of his personal effects or that of his business, is of a kind that the ordinary assessor (in his daily life) is unfamiliar with, and it is also of a kind that is difficult of valuation. This is true not only of the wealthy individual but of the wealthy corporation as well. In regard to the former, the valuation of such property as jewelry, works of art, books, etc., require a knowledge and skill not possessed by the average assessor. In regard to the rich corporations, such as mercantile corporations, carrying large stocks of fine fabrics, jewelry, etc., and those manufacturing corporations having machinery of great value as well as large stocks of products in the process of manufacture, the experience of forty-eight states of the Union discloses with unmistakable clearness that the average assessor does not and cannot assess these subjects with any degree of fairness.

When we come to investment in securities, a large investor usually has the knowledge, or can obtain such advice, as will enable him to invest in tax-exempt securities, while the small investors, particularly women, are apt, through ignorance, to invest in taxable bonds.

3. Concerning widows and orphans and trust estates. If there is one group of property which should escape with reasonable taxation, it would seem to be that property the income from which is set aside for the support and education of those who have been deprived through death of the head of the family, viz., the widows and the orphans. When the chief bread-winner dies, a record of his property must be filed in the probate court, where it is easily accessible to the tax assessors. Here it is caught and taxed, while similar property held by others is untaxed. Were it taxed at only a fair rate, it would still be questionable whether this property ought not to be partially exempt. However, it is not taxed at a fair rate, but at a rate which makes the personal property tax in this case one of the most barbarous

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to be found in any country. Cases are frequent where as high as 25 to 50 per cent of the total income set aside for the support of widows and orphans is taken by this tax. How serious the situation is was well exemplified by investigation made by one of the witnesses who appeared before the Committee. He stated that he found that in one county (not in the state of New York) the roll showed that about 20 to 25 per cent of the personal property taxes were paid by women. It will, of course, be readily agreed that women do not own anything like 25 per cent of personal property in any state. Another witness told us of a woman whose husband had died leaving an estate all invested in 4 per cent bonds. The woman was assessed by New York City's Tax Department for the full value of the bonds. There was no possibility of getting the tax reduced. Counsel advised her to change her investments, but she refused to do that because her husband had made them, so she was obliged to leave the city and change her residence.

A simple example will illustrate how this tax works. Assume that a prudent head of a family had been able to save $15,000 which had been invested in municipal bonds yielding 4 per cent. The annual income to the widow would be $600. At a tax rate of 2 per cent on the value of this personal property, the widow would be compelled to surrender $300 to the tax authorities or one-half of her total income. In some localities tax rates have risen as high as 3 or 4 per cent and cases are not unknown where, had the tax law been enforced, the widow would have been deprived of her entire income. Indeed, cases are known where the tax has not only absorbed all of the income, but has compelled the owner to pay an additional amount. In the 1915 New York Tax Conference, Mr. Lawson Purdy cited such a case. Before the December, 1915, hearings of the Joint Legislative Committee on Taxation, Professor Charles J. Bullock of Harvard University testified that cases of such gross injustice amounting to the taking of from one-third to one-half of the income of widows and orphans were not infrequent where the general property rate was applied to personalty. Upon this point, the Report of the Massachusetts Tax Commission for 1908 speaks as follows:

The situation is made worse by the fact that the local tax rates throughout the country are so high that they take from the holder of good securities an excessive proportion of his income. According to the United States census, the average rate levied upon property assessed for

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local taxation in the United States in 1902 was about 2 per cent of the capital value thereof, or as tax rates are usually reckoned in Massachusetts, $20 on each $1,000 of the assessed valuation. In many places real estate was so far undervalued that a tax of 2 per cent upon the assessed value may not have amounted to more than 1 per cent or even ½ of 1 per cent of the true value of the property. But personal property, if returned for taxation, must be valued usually at its true cash value; and it is clear that a tax rate of 2 per cent may take from the holder one-third or one-half of his income. Under such circumstances few persons can or will make returns of their personal estates; and the usual result is that this property is taxed by the method of arbitrary estimate, or "doomage." When returns are made they come usually from trustees and executors of small estates, who cannot easily evade the law, and have less inducement to do so. Thus it comes about that the tax on personal property bears with exceptional severity upon widows and orphans, the most helpless class in the community, and is most easily evaded by the rich and powerful, who can best afford to pay it. Instances have come to the attention of members of the present Commission in which widows are paying upon small estates taxes that take as much as 40 or 50 per cent of the income; whereas in the same communities men whose taxable property would probably amount to millions are paying a few hundred dollars of personal taxes upon merely nominal assessments. These conditions are not peculiar to Massachusetts—they have been repeatedly disclosed by the reports of tax commissions in other states; and among students of American taxation it has become a mere truism that our present taxes upon personal property actually fall upon the taxpayers in inverse proportion to their ability to pay.

4. As between farms and other forms of wealth. That the farmers bear a disproportionate share of taxation is generally known and accepted by most of the informed throughout the United States. It is not generally known by the farmers or the public at large, however, to what an extreme degree this disproportion is carried. It is, of course, well known that most of a farmer's personalty is in a tangible form, and that it cannot be hidden from the tax assessor. Wherever the law is enforced the farmers' machinery and implements, his stock and other tangibles not only pay a much higher rate than their share, but a rate out of all proportion to the earning power of such property. This disproportionate rate is, of course, largely made up of that part of the tax burden that is evaded by other forms of wealth. The full significance of this inequity cannot be grasped without comparing the rates upon agricultural property and income with that of the other principal industries of the state.

A study of California in this regard is of much value to New York. A few years ago a very careful investigation was made of the relative tax burdens borne by the various classes of wealth in California, and the results of this investigation were set forth in the 1906 California Tax report. Most of the statistics given immediately below are either copied from that

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report or represent computations based upon the data there set forth. The following table taken from page 68 of this report is a comparative statement of manufacturing industries and agriculture in respect to the capital investment, percentage of total capital value invested in realty and personalty, and percentage of each taxed:

COMPARISON OF TAXES ON MANUFACTURING AND FARMS IN CALIFORNIA

	Aggregates		Percentage of total capital	
	Manufactures	Agriculture	Manufactures	Agriculture
Capital total	$205,395,025	$796,527,955	100.0	100.0
Land	34,735,416	630,444,960	16.9	79.0
Buildings	22,562,385	77,468,000	11.0	9.7
Machinery, resp. implements	62,440,759	21,311,670	30.4	2.7
Other assets	85,656,465	67,303,325	41.7	8.5
Assessed value	63,500,000	474,731,497	31.0	65.0
Taxes	1,049,932	9,030,000	.51	1.14
Gross produce	302,874,761	131,690,606	147.0	16.5
Net product	52,172,862	91,419,866	25.4	11.5
Taxes of gross			.346	6.86
Taxes of net product			2.01	9.88

This table discloses some very interesting facts; and these facts are of considerable interest to New York, because they illustrate a condition in California very similar to the one now prevailing in New York State. At least this is true in so far as they illustrate the inequity existing between farm property and that of other forms of wealth. It should be remembered, however, that the actual inequity as between these two forms of wealth is probably greater in New York than in California.

The above table shows that while agriculture pays 6.86 per cent of its gross product in taxes, manufactures pay only .34 per cent or ⅓ of 1 per cent. In other words, measured in terms of gross product, the tax burden upon agriculture was about twenty times as heavy as that upon manufactures. In terms of net product, the disproportion, though not so extreme, is still very large. The table shows that while manufactures pay 2.01 per cent of net products in taxes, agriculture pays 9.88 per cent in taxes. In other words, the tax burden measured in terms of net product is nearly five times upon agriculture what it is upon manufacture. It should be noted here that this statement is based upon the assumption that manufactures pay approximately 2 per cent of net income in California. This rate is probably higher than that borne by manufactures in New York State. Statistics such as those gathered by the Federal Census indicate that the proportion borne by manufactures in New

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York is less. These facts are brought out in more detail in part VIII of this report which deals with the taxation of manufacturing corporations.

The following table summarizes the tax burdens borne by California farms:

Per cent of taxes to true value	1.14
Per cent of taxes to gross returns	6.86
Per cent of taxes to net returns, including farmer's own compensation and certain expenses	9.88

The following tabulation compares the percentage of tax paid by farms and manufactures:

	Farms	Manufactures	Ratio of farm taxes to manufacturing taxes
Percentage paid on capital value	1.14%	1/2 of 1%	3 to 1
Percentage paid on gross income	7.00%	1/3 of 1%	20 to 1
Percentage paid on net income	10.00%	2%	5 to 1

In regard to the comparative burdens borne by various kinds of wealth in New York State, no study similar to that of California has been made with the same degree of care and thoroughness. The New York problem is much more complex than that of California. The multiplicity of corporation taxes at varying rates and upon different bases makes the difficulties of a similar study for New York almost insurmountable. We have, however, sufficient data to justify a rough comparison between New York and California and between New York and states like Minnesota and Michigan that have also made studies similar to that of California. These comparisons all indicate that the disparity as between agriculture and other forms of wealth is even greater in New York.

An examination of Minnesota's experience is pertinent. The following facts are gathered from the experience of Minnesota as it appears in the 1908 Report of the State Tax Commission of Minnesota (p. 54-5):

The special commission on revenue and taxation of 1906 appointed by the governor of California declared that the percentage of taxes to the gross products for manufactures in that state was .346, or about 1/3 of 1 per cent; for agriculture the relation of taxes to total product was 6.86 per cent. On the net product of manufactures the commission found the relation of taxes to be 2.01 per cent, and for agriculture 9.88 per cent. The basis of these figures is the United States census of 1900. Applying the same methods and the same data to Minnesota, a

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somewhat different result is obtained. Expressed in the terms of product, the percentages of taxes to the returns secured from manufacturing and agriculture are as follows:

Taxes to gross product—Manufacturing	.3223%
Taxes to gross product—Agriculture	4.7200%
Taxes to net product—Manufacturing	2.0480%
Taxes to net product—Agriculture	6.8850%

TABLE SHOWING COMPARISON OF AGGREGATES AND PERCENTAGES OF INVESTMENTS IN MANUFACTURE AND AGRICULTURE IN MINNESOTA

Capital Items	Aggregates		Percentages	
	Manufactures	Agriculture	Manufactures	Agriculture
Land	$29,548,954	$559,301,900	17.810	70.90
Buildings	19,850,136	110,220,415	11,980	13.97
Machinery	37,953,943	30,099,230	22.886	3.83
Other assets	78,479,213	89,063,097	47.324	11.30
Total capital	$165,832,246	$788,684,642	100.00	100.00

The assessed value of manufactures was $32,509,514, and of agriculture $299,567,765. Reduced to percentages, the relation of the assessment of manufactures to capital was 19.6 per cent, and of agriculture, 37.9 per cent. The manufactures paid $846,570 in taxes and agriculture $7,609,021; in other words, .51 per cent and .96 per cent, respectively, of their capital values. The gross product of the manufacturers of the State amounted to $262,655,881, or 158.3 per cent of the capital invested in manufactures, and the agricultural product was $161,217,304, or 20.4 per cent of the capital invested. In the case of the net product, the manufactures of the state earned $41,318,363, or 24.9 per cent on their capital, and agricultural interests $111,050,884, or 14.08 per cent.

Manufacturers pay a little more than 2 per cent on their net product, and farmers pay more than three and one-third times as much as when measured on the same basis; and on the basis of gross product the farmer pays more than eleven and one-half times the amount turned in by the manufacturer for taxes. On a net income basis the manufacturer pays 2 per cent of it for taxes, but the farmer pays nearly 7 per cent of his net income, which includes the benefits he receives from his garden, poultry, etc. And, further, the farmer's net income includes his reward for management as well as interest return. These items make the difference still more marked.

These are eloquent figures. While the commission is not ready to accept them in their full meaning as conclusive, they do show clearly the general situation.

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The experience of Michigan is also of much value, although the disparity between farms and manufactures is probably not so great as it is in the state of New York. The following table is taken from the 1911 Report of the Commission of Inquiry into Taxation of Michigan (p. 9).

It gives the rate of taxes per thousand of actual value for farms, banks, residence, railroads, manufacturing corporations, public service corporations and mines. It also gives a comparison of the value and taxes paid by each of these classes except residences:

	Values	Taxes	Rate per $1,000
City real estate	....	....	$14.85
Farms	$1,000,000,000	$10,000,000	10.00
Banks and trust companies	75,000,000	1,250,000	17.00
Railroads	212,000,000	4,378,000	20.65
Sleeping car, express, car loaning and telephone and telegraph companies	24,000,000	493,000	20.67
Manufactures	750,000,000	3,938,000	5.31
Mines	250,000,000	1,750,000	7.00
Electric railway, power, heat, light and gas companies	130,000,000	900,000	7.00

An examination of this table discloses the fact that manufactures bear the lowest rate of taxation of any class of wealth in Michigan, this rate being about one-fifth of that of the public service corporations, about one-half that of farm property and about one-third that of city real estate. This table is of value in so far as it throws light upon the disproportion of the tax burden. It should be clearly borne in mind, however, that the disproportion between manufactures and farms is very much less than in either California or New York.

In view of the great inequality as between the actual assessment of farmers and manufacturers, it is of considerable interest to know whether any compensation is found in the difference in their tax-paying ability. The following quotation from page 66 of the 1906 California Report is very clear upon this point:

> The same facts may be exhibited in another way. After allowing $2,446,238 for the average annual increase in value of farm property and taking 6 per cent as interest on the value of farm property, the census estimates that the 145,801 persons engaged in agriculture earned an average of $499.70 in 1899. The 113,155 persons engaged in manufactures earned an average of $870.
>
> It would seem, then, that from the per capita earnings manufacturers could afford to pay nearly 75 per cent more taxes than could the farmers. As a matter of fact, however, the farmers pay 10 per cent of their net earnings and manufacturers only 2 per cent of their net earnings.

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The present personal property tax works a severe hardship upon the property of farmers, irrespective of whether the tax is rigidly enforced or not. If the tax is actually enforced upon the personalty of farmers it obviously lays a highly disproportionate burden upon that part of the farmer's wealth. In answer to this statement it is often said that the personal property tax does not discriminate against the farmer inasmuch as the average assessor does not actually assess any considerable amount of the tangible personalty found upon farms. It is true that to the extent that an individual farmer is underassessed by the local tax officer he escapes a certain part of a highly disproportionate burden. It is utterly fallacious, however, to infer that in escaping to this extent the farmer is freed from the inequities of the personal property tax. The greatest injustice to the farmer arises from the indirect results of the almost complete failure of the general property tax as applied to personalty in general. When practically one-half of the tax base escapes in the form of personalty, the rate upon the remaining half must be double what the rate would be, were it levied uniformly upon the entire base. To the extent, therefore, that anyone's wealth is composed of real estate, to just that extent does he bear an increased disproportionate share of the tax burden.

A reference to the above tables from the California report is illuminating at this point. The first table shows that 79 per cent of the total value of agriculture is invested in land and that 88.7 per cent is invested in land and buildings. Manufactures, on the other hand, have invested in land only 16.9 per cent of total capital and only 27.9 per cent in land and buildings. Personalty of manufactures makes up 72.1 per cent, of which not less than 50 per cent is intangible. The significance of these figures must not be overlooked. They show not only that that part of the fair share of personalty escaping taxation is borne to a very large degree by agriculture, but that that particular burden is partly accounted for by the failure of the assessors to reach the very large per cent of the capital of manufacturing and other corporations that is represented by personalty.

It must not be understood that manufactures represent the only group of wealth that shoves off part of its tax burden upon the farmer. The manufacturing industry has been used for purposes of illustration, and did space permit, it could be shown

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that other business corporations as well as some of the public service and financial corporations fail to bear a tax burden proportionately as heavy as that of agriculture.

In answer to the above arguments it is often said that the farmer suffers no injustice because as his tax burden increases, the value of his land increases. Wherever the increase in value of this land assumes the form of the so-called "unearned increment," this fact may be true in those particular cases in which the increment is as large as the tax increase. In those cases, however, where the increased value of the farm has been due to the labor and capital investment of the farmer, it cannot be truthfully said that the increased value "takes care of" the increase in the tax burden. In any case where the property has not increased in value, the increased burden is a heavy one.

In summing up the case of the farmer, the evidence is well nigh overwhelming that the general property tax in so far as it pertains to personalty, directly or indirectly, imposes on him an increasingly disproportionate burden.

5. Injustice as between various types and classes of enterprises. As the personal property tax is now levied in New York, it constitutes not only a serious impediment to the development of some businesses, but a constant annoyance to many branches of business. It is unjust as between various units of business and types of corporations. It is unjust as between mercantile and manufacturing corporations and it is unfair to corporations within the same group. The extreme to which this unfairness is carried is illustrated by the ridiculous differences in the percentage of personalty assessment to total assessment in the same counties. In the same type of business, the ratio of personalty to realty sometimes varies from 1 to 2, to 1 to 75. In the same town the personalty of manufactures escapes while the personalty of mercantile corporations is assessed. Moreover, local mercantile corporations are taxed upon personalty, while foreign corporations, doing large business next door and carrying large stocks of personalty, are taxed neither in the locality nor at their domicile.

The unfairness as between manufacturing corporations of nearby competing towns is often very great. In fact the present investigation discloses the fact that in general throughout the state of New York the personal property tax bears to business the relation of an unmitigated nuisance. Were the law fully enforced, it would drive business out of New York; with

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present sporadic enforcement it falls with inequality and injustice.

6. As between the various counties in New York State. Reference to the comparative statistical tables in the appendix will show with what wide difference personalty is actually assessed in the different counties of the state. When the direct state tax is levied, the inequalities in the assessment of real estate are partly remedied by equalization. With personalty, however, all inequalities remain, because the board of equalization does not equalize personal property, but accepts the returns of the various counties. Thus the more efficient the personal property tax is levied in any county, the higher the percentage of the direct state tax that county is required to pay. In other words, the present law penalizes every county in proportion to its efficiency in enforcing the law.

THE PROPOSED PERSONAL INCOME TAX [1]

The first decision reached by the committee was that in the proposed model system of state and local taxation there should be a personal tax levied with the exclusive view of carrying out the principle that every person having taxable ability should pay a direct tax to the government under which he is domiciled. There appeared to be four forms of personal taxation which have been employed for this purpose.

The first of these is the poll tax. It is evident, however, from the nature of the case that this tax would be utterly inadequate to accomplish the object in view, even if levied at graduated rates, as has sometimes been done in other countries. It would be so unequal and so far inferior to the other forms of personal taxation that it cannot be deemed worthy of serious consideration. Whether, as a supplement to an adequate system of personal taxation, it might be desirable to retain the poll tax as a means of insuring some contribution from people owning no property and having small incomes, the committee preferred not to consider in this report. It has been our desire to confine ourselves to main issues, and not to

[1] From the Report of the committee appointed by the National Tax Association to prepare a plan of a model system of state and local taxation. p. 10-19.

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undertake to solve every minor problem of taxation. We, therefore, say nothing about the poll tax, except that it is inadequate for the purpose that we have in view, and cannot be recommended as an important element in any system of state and local taxation.

The second method of imposing the personal tax would be to levy a tax upon every man's net fortune, that is, upon the total of his assets in excess of his liabilities, without exemption of any kind of asset or exclusion of any liability. This would not mean a general property tax, but a net property tax such as is found in some countries in Europe. It would be a tax levied not upon property as such, but upon net fortune as a measure of the citizen's personal liability to contribute to the government under which he is domiciled. It would be entirely distinct from any tax that might be levied objectively upon property, as property. at the place of its situs, and would have to be levied exclusively upon the property owner at his place of domicile. It would necessarily be levied at a moderate rate, perhaps $3 per $1000, which would correspond approximately to a 6 per cent income tax upon investments yielding 5 per cent. Although precedents may be found in other countries for such a personal tax levied upon net fortunes, the committee has concluded that it is not to be recommended for adoption in the United States. Such a tax would raise the difficult constitutional question of the right of a state to levy a tax even upon the *net* fortune of a citizen if that fortune included tangible property located in another commonwealth. It is, furthermore, foreign to American experience, and would certainly not lead us along the line of least resistance. Since the coming of the federal income tax, it is obvious that it is easier for the states, and more convenient for the taxpayers, to adopt income rather than net fortune as the measure of the obligation of the citizen to contribute to the government under which he lives.

The third method of personal taxation is what may be called a presumptive income tax, that is, a tax levied upon persons according to certain external indicia which are taken to be satisfactory measures of taxable ability. House rent is the index commonly used in such presumptive income taxes, and a tax on rentals has been proposed in times past by special commissions in Massachusetts and New York. Such a tax would be comparatively easy to administer, and would raise no difficult

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constitutional questions. It would undoubtedly be better than an income tax or a tax on net fortunes if those taxes were badly administered. But the amount that a citizen pays for house rent is after all such a very imperfect and inadequate indication of his income or fortune that the committee is unwilling to recommend it to any state in which there is any reasonable expectation that conditions are, or may presently become, favorable for the introduction of a better form of personal tax. It appears that in France, where the tax on rentals has been in continuous operation since the Revolution, there is so little correspondence between house rents and taxable ability that in the greater part of the communes the taxing officials disregard to a greater or less extent the letter of the law, and assess people according to what they appear able to pay. The committee finds, therefore, that the tax on rentals is not to be recommended except, perhaps, as a last resort in states where administrative and other conditions are unfavorable to the introduction of any better form of personal taxation.

There remains a fourth form of personal taxation, the personal income tax. By this is meant a tax levied upon persons with respect to their incomes which are taxed not objectively as incomes but as elements of determining the taxable ability of the persons who receive them. This tax is better fitted than any other to carry out the principle that every person having taxable ability shall make a reasonable contribution to the support of the government under which he lives. It is as fair in principle as any tax can be; under proper conditions, it can be well administered by an American state, as Wisconsin and Massachusetts have proved; it is a form of taxation which meets with popular favor at the present time, and therefore seems to offer the line of least resistance. The committee, therefore, is of the opinion that a personal income tax is the best method of enforcing the personal obligation of the citizen for the support of the government under which he lives, and recommends it as a constituent part of a model system of state and local taxation.

While it is impossible in this report to describe the proposed taxes in every detail, it is essential that the committee should explain at least in broad outlines the manner in which these taxes should be levied. In so doing it will be necessary to refer constantly to the general principles previously stated, and to adjust

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the details of each tax in such a manner as to enable it to carry into effect logically and consistently the principle upon which it is based.

Since the purpose of the personal income tax is to enforce the obligation of every citizen to the government under which he is domiciled, it is obvious that this tax must be levied only upon persons and in the states where they are domiciled. It is contrary to the theory of the tax that it should apply to the income from any business as such, or apply to the income of any property as such. The tax should be levied upon persons in respect of their entire net incomes, and should be collected only from persons and at places where they are domiciled. It should not be collected from business concerns, either incorporated or unincorporated, since such action would defeat the very purpose of the tax.

At first thought this proposal will doubtless seem objectionable to many, who will ask why a state should not tax all incomes derived from business or property located within its jurisdiction, irrespective of whether the recipients are residents or non-residents. And if the personal income tax were the only one proposed, the objection would be well grounded. The committee, however, is under the necessity of reconciling the conflicting claims of the states, and of doing so in a manner that will avoid unjust double and triple taxation of interstate business and investments. We, therefore, propose as the only practicable remedy a system which comprises three taxes, each of which is designed to satisfy fully and fairly the legitimate claims of our several states. We are elsewhere providing methods by which property will be taxed where located and business will be taxed where it is carried on. At this point, we are dealing exclusively with a personal tax designed to enforce the right of our states to tax all persons domiciled within their jurisdictions; and we are merely insisting that, in enforcing this claim, the states shall act consistently, and shall confine personal taxation to persons and attempt to levy it only at the place of domicile. If the personal income tax is levied in any other way, it will simply reproduce and perpetuate the old evil of unjust double taxation of interstate property and interstate business.

The second detailed recommendation we have to make is that the personal income tax shall be levied in respect of the citizen's entire income from all sources. Under existing

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constitutional limitations, of course, interest upon the bonds of the United States and the salaries of federal officials cannot be taxed by the states, but we recommend that all other sources of income be subject to the income tax without exception or qualification. We are aware that, under the unreasonable and unworkable requirements of the general property tax, it has appeared desirable in times past to exempt state and local bonds from taxation, to exempt real estate mortgages, and to grant various other exemptions. All such exemptions are inconsistent with the theory of the tax we here propose, and should be discontinued as rapidly as the circumstances of each case permit. Against the policy which led to these exemptions under the general property tax we here offer no criticism. But we are now dealing with a tax which is designed to be a part of a new system of taxation, and it is evident that none of the considerations which led to the exemptions created under the general property tax are applicable to a personal income tax levied upon the principle we here advocate. The personal obligation of the citizen to contribute to the support of the government under which he lives should not be affected by the form his investments take, and to exempt any form of investment can only bring about an unequal, and therefore an unjust distribution of this tax. Our reasoning applies, of course, to the exemption which agencies of the federal government now enjoy. But that is a matter which is beyond the control of the states, and for the purposes of this report it will be considered a fixed datum which must be accepted.[1]

Our third specific recommendation is that the personal income tax should be levied upon net income defined substantially as a good accountant would determine it. We submit no formal definition at this time, and content ourselves with referring to the provisions of the Wisconsin and the Massachusetts income taxes. Our recommendation means that operating expenses and interest on indebtedness must be deducted, but we wish to call attention to the fact that the issue by the federal government of large amounts of bonds which are exempt

[1] We here follow the view that has long prevailed concerning existing restrictions on the taxing power of the states. In two recent cases (Peck v. Lowe and U.S. Glue Co. v. Oak Creek, 247 U.S.) the court has developed a doctrine which may justify the belief that a net income tax, levied upon state officials along with all other persons, with respect to their entire net incomes, might not be held to be a tax upon agencies of the federal government, and therefore forbidden by federal decisions.

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from local taxation will make it necessary for the states to limit the interest deduction to an amount proportional to the income which the taxpayer derives from taxable sources. This would mean that if a person derives half of his income from taxable sources and one-half from tax-exempt federal bonds, he should be permitted to deduct but one-half of the interest that he pays upon his indebtedness. Any other procedure will tend to make the personal income tax a farce in many cases and will give occasion for legitimate complaint.

The fourth recommendation relates to the exemption of small incomes. The committee believes that the amount of income exempted from the personal income tax should not exceed $600 for a single person and $1200 for a husband and wife, with a further exemption of $200 for each dependent up to a number not to exceed three. This would give us a maximum exemption of $1,800 for a family consisting of husband, wife, and three children or other dependents. We recognize, however, that conditions may well differ in various states, and have decided to make no specific recommendations about the amount of the exemptions granted to persons having small incomes. We limit ourselves to the above statement of the maximum exemptions that should be granted and the further observation that, under a democratic form of government, it is desirable to exempt as few people as possible from the necessity of making a direct personal contribution toward support of the state.[1]

Our fifth recommendation is that the rate of the income tax shall be the same for all kinds of income, that is, that it shall not be differentiated according to the sources from which income is derived. If the tax stood by itself, a strong argument could be made for imposing a higher rate upon funded than upon unfunded incomes. But the tax is, in fact, designed to be part of a system of taxation in which there will be a tax upon tangible property. Under this system there will be heavier taxation of the sources from which funded incomes are derived; and there will, therefore, be little if any ground for attempting to differentiate the rates of the personal income tax. Such differentiation, furthermore, would greatly complicate the

[1] For administrative convenience we recommend that, in order to minimize the number of very small tax bills, no person liable to pay an income tax shall be assessed for less than $1.00.

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administration of the tax, and would lead to numerous difficulties. Upon all accounts, therefore, we recommend that there shall be no differentiation of the rate.

In the sixth place, we recommend that the rates of taxation shall be progressive, the progression depending upon the amount of the taxpayer's net income. Concerning the precise schedule of rates, we offer certain general recommendations. The lowest rate should not be less than 1 per cent, and under present conditions we regard it as inexpedient for any state to impose a rate higher than 6 per cent. The classes of taxable income to which the various rates apply need not be smaller than $1,000, and probably should not be larger. It results from what has been said that if the exemption to a single person be placed at $600, we would recommend a tax of 1 per cent upon any amount of income between $600 and $1,600; a tax of 2 per cent upon any amount of income between $1,600 and $2,600; a tax of 3 per cent upon any amount of income between $2,600 and $3,600; a tax of 4 per cent upon any amount of income between $3,600 and $4,600; a tax of 5 per cent upon any amount of income between $4,600 and $5,600; and a tax of 6 per cent upon all income in excess of $5,600. We present these figures merely for the purpose of illustrating our preferences, and make no definite recommendation except that the rates of the personal income tax should be moderate, and should be, as nearly as practicable, uniform throughout the United States.

Our seventh suggestion concerns the administration of the proposed tax. No argument can be needed by the National Tax Association to support our recommendation that the administration of the personal income tax should be placed in the hands of state officials. This we regard as an indispensable condition for the successful operation of any state income tax, and we should be disinclined to recommend the adoption of an income tax by any commonwealth that is unwilling to turn over its administration to a well organized and properly equipped state department. Local administration of an income tax has never worked well, and in our opinion, never can operate satisfactorily. It is obvious, finally, that a state tax commission, or commissioner, is the proper agent to administer the proposed tax; and we desire to record our belief that satisfactory results are hardly to be expected if the administration is turned over to any other state officials. Upon this whole question of administration,

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which is of the most vital importance, we are fortunate in being able to rely upon the authority of the opinions repeatedly expressed by the conferences of the National Tax Association. We are glad also to point to the experience of Wisconsin and Massachusetts.

Our eighth recommendation is that the personal income tax be collected from taxpayers, upon the basis of strictly enforced and controlled returns, and without any attempt to collect it at the source. Upon this point there might have been doubt several years ago. But the experience of Wisconsin and Massachusetts shows conclusively that, with good administration, a reasonable tax upon incomes can be collected in the manner we have recommended, with the general cooperation of the taxpayers and with the minimum amount of evasion. Collection at source presents serious administrative difficulties, imposes unwarranted burdens upon third parties in respect of transactions which strictly concern only the taxpayers and the government, and not infrequently tends to shift the burden of the tax to the wrong shoulders. What we seek is a personal tax which shall not be shifted and shall bring home to the taxpayer, in the most direct possible form, his personal obligation for the support of the government under which he lives. Collection at the source is plainly inconsistent with the purpose of such a tax. We recommend, however, that in certain cases information at the source be required as is now done under the Massachusetts and Wisconsin income taxes. Such information is helpful to the administrative officials, and does not alter the incidence or otherwise affect injuriously the operation of a personal income tax.

The only remaining point is that of the proper disposition of the proceeds of this tax. So far as our general plan of taxation is concerned, it is immaterial whether the revenue from the personal income tax is retained in the state treasury, distributed to the local political units, or divided between the state and local governments. It is probable, furthermore, that the same solution may not be advisable in every state. If the state should keep the entire revenue, then every section of the state would benefit to the extent that such revenue might reduce the direct state tax. Upon the other hand, if the revenue from the income tax is distributed wholly to the local units, as is now the case in Massachusetts, the lightening of local burdens tends to reduce the pressure of the direct state tax. It seems probable

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that in most cases a division of the revenue would be considered preferable; and in such cases we suggest that the state governments might well retain a proportion corresponding to the proportion which state expenditures bear to the total of the state and local expenditures, and that the same principle should apply in determining the share received by each of the subordinate political units. Thus in case state expenditures amount to one-fifth of the total, county expenditures to two-fifths, and municipal expenditures to two-fifths, the state should receive one-fifth of the revenue from the income tax, the counties two-fifths, and the municipalities two-fifths. Whether distribution to the local units should be made upon the basis of the amount of tax collected in each unit, or whether the tax should be distributed upon some other basis, is also immaterial to our general plan of taxation. In states where domiciliary changes occurring under the general property tax have not produced an unnatural concentration of wealth in certain localities, it will probably be best to distribute the revenue according to the domicile of the taxpayers. But where, as in Massachusetts, under the operation of the general property tax, wealth has been greatly concentrated in a few localities, such a method of distribution is obviously impossible and some other method must be found. In such a case, the income tax revenue might be utilized for a state school fund, or might be distributed among the localities according to the proportions in which they are required to contribute to the direct state tax. Since this entire question of distribution must be so largely affected by local conditions, the committee prefers to do no more than to offer these general suggestions.

WHAT RIGID ENFORCEMENT WOULD MEAN [1]

Tax rates and valuations are determined by the demand for public revenue. Needs for public revenues in Illinois, as in all other states, are increasing constantly with the new demands which are being made upon government.

To meet these demands under the present system, present rates must be increased and applied, generally, to increased valuation of property already taxed. With proper constitu-

[1] Civic Federation of Chicago. Taxation and Public Finance. p. 16-17.

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tional changes, revenues from new sources derived in an equitable manner by methods worked out in other states, may be reasonably expected. This will tend not only to relieve from undue share of the prospective increase, property already taxed, but to equalize the future burdens between property which now pays heavily and property which pays little or frequently nothing.

Rigid enforcement of the present system sometimes is urged by the superficially inclined as a cure for present inequalities. The following are a few of the developments which would attend a real attempt at rigid enforcement:

1. Greatly increased and probably intensely centralized powers of assessment and an army of deputies working constantly throughout the year.

2. Heavy penalties with provisions for rigid enforcement against delinquents.

3. An inquisitorial drag-net by which the assessors would attempt to question every possible holder of intangible wealth.

4. Persons having no taxable property would be put to the expense and inconvenience of establishing their innocence of criminally hiding property.

5. Intangible property of every kind, regardless of income-producing ability, would have to pay taxes by value out of its net income. This would operate to create higher interest rates, necessitating greater profits from all real property and increasing rents and the cost of living.

6. Money in bank would be taxed at a rate so much higher than the rate of exchange that it would go to more favorable jurisdictions, creating financial stringency in Illinois, at least during the assessment period. Already this tendency has been observed in some parts of the state.

7. Even if bank runs and bank closings did not result, the banks would be compelled to pay a higher rate of interest on deposits to make up for the tax rate, and this would increase the interest rate on all sorts of loans.

8. A confiscatory tax rate even more than now would be a menace confronting every prospective investor in Illinois, and to many times the extent which it now deters new capital for purchase of existing tangible property from coming into this state, it would operate to depreciate all values of all intangible

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property by diminishing the market for it. Other states would profit by the hegira of capital from Illinois, and this state would be retarded in its economic growth and development.

9. Every stick of furniture, every wash-boiler, every pick and shovel and hammer and saw, would have to contribute its mite, regardless of petty annoyance—and frequent hardships—on the part of thousands of individuals, and of a cost of assessment and collection far exceeding the revenues derived.

Industrialism—employer and employee alike—would be injured by a rigid enforcement of the present uniform property tax system, even if it were done in the most impartial manner possible.

BRIEF EXCERPTS

We have found that the general property tax is a failure, for purposes either of revenue or equality; that more than half of the total wealth of the state in tangible property alone escapes taxation; that of intangible property, such as moneys, credits, stocks and bonds, subject to taxation under existing laws, not 10 per cent perhaps not even 5 per cent is listed on the duplicates. *Report of the Tax Commission to the Governor of Ohio. 1908. p. 33.*

Practically the general property tax, as actually administered today, is, beyond all peradventure, the worst tax known to the civilized world. . . It puts a premium on dishonesty and debauches the public conscience. It reduces deception to a system and makes a science of knavery; it presses hardest on those least able to pay. It imposes double taxation on one and grants immunity to the next. In short, the general property tax is so flagrantly inequitable that its retention can be explained only through ignorance or inertia. *Edwin R. A. Seligman. The General Property Tax. p. 52.*

One of the pertinent observations of the [Special State Tax] Commission [of California, 1905] is applicable perhaps to every state. It is on the steady increase of tax burdens. "The people continually demand more and more of the various branches of the Government and the burden upon the property holders

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increases at a very rapid rate. . . The growth in the burden of taxation has been much more rapid than the growth in population." And figures are given showing the growth of population from 1860 to be 4.3 fold, while taxation increased during the same period 9.2 fold. Therein lies the necessity of discovering new sources of revenue, and sources, too, that can be reached more certainly than the tax on personal property, particularly of intangible character. *The Civic Federation of Chicago. A Summary of the Reports of Special State Tax Commissions. p. 10.*

A survey of the field of state income taxation shows that thirteen states have income tax laws in some form upon their statute books. The laws of West Virginia, Montana and Connecticut provide for business taxes on the net income of corporations only. The laws of Mississippi, Missouri, North Dakota and Delaware are so recent that practical results are not ascertainable at this time. New Mexico has made no attempt to apply her law which was repealed by the legislature in 1919, but the governor vetoed the repealing act. Virginia and North Carolina have laws which are a survival of Civil War acts and have not been prolific revenue producers. Oklahoma has a law with the specific exemption so high that the receipts are materially reduced. New York, Massachusetts and Wisconsin have comprehensive laws which have shown favorable results. *Frank D. Strader. Proceedings National Tax Association. v. 13.*

Since about 1885 there has been a marked increase in state and local revenues throughout the country and in fact throughout the western world. This growth has been especially marked during the last dozen years. On every hand the complaint is made of the increasing burden of taxation. For a quarter of a century writers on public finance have called attention, sometimes with alarm, to the growth of public expenditures. In the main, however, this increase is looked upon as a natural growth. The functions of government have been constantly widening; all the old services are continued; new ones are constantly being undertaken; and new and old are being conducted on a higher plane than formerly. Citizens are no longer content with mere room and convenience, but demand something of elegance, in their public buildings. They are no longer satisfied that their

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duty is performed toward the unfortunate wards of the state by providing them shelter and food, but feel impelled to make use of all the methods of modern science to remove their abnormalities and restore them when possible to the usual paths of life. *Report of the Special Commission on Revenue and Taxation. Nebraska. 1914. p. 23.*

Income taxes in almost every imaginable form have been tried for many years in some of the eastern and southern states. The following is a rough summary of the periods for which income taxes, in some form or other, have been in force in twenty of the states, the colonial and statehood periods being combined:

State	From	To	
Alabama	1844	1884	
Connecticut	1649	1819	
Delaware	1869	1871	
Florida	1845	1855	
Georgia	1863	1866	
Kentucky (as to U. S. Bonds)	1867	1871	
Louisiana	1865	1910	
Maryland	1842	1850	
Massachusetts	1843	1910	
Missouri	1861	1866	
North Carolina	1849	1910	
Oklahoma	1908	1910	
Pennsylvania	1841	1871	
Rhode Island	1673	1750	(?)
South Carolina	1838	1868	
" "	1898	1910	
Tennessee (as to U. S. Bonds)	1883	1910	
Texas	1863	1871	
Vermont	1777	1782	
"	1778	1850	
Virginia	1843	1910	
West Virginia	1863	1864	

(Where the year 1910 is given above, the intention is to state that the law is not yet repealed.)

K. K. Kennan, Income Taxation. p. 209-10.

The first of the modern state income tax laws was passed by the legislature of Wisconsin in 1911. In this state the movement for an income tax received its first impetus in the very general dissatisfaction which had been aroused by the inequitable operation of the property tax as applied to personal property. A constitutional amendment authorizing an income tax was adopted in 1908 by a large majority. A tentative measure was introduced in 1909 and adopted in 1911. From the very outset the success of this measure was in such marked contrast with the earlier state experiences that a number of states have

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since resorted to this form of taxation, though not all of them have seen fit to follow the Wisconsin law in its most distinctive features, that is, its administrative methods which, more than anything else have made it successful.

The state income tax laws adopted since 1911 have been the following, which is a complete list so far as the writer can discover; West Virginia, Oklahoma, Connecticut, 1915; Massachusetts, 1916; Missouri, Delaware and Montana, 1917; New York, 1917 and 1919. Income taxes of the older sort are still in force in Virginia, North Carolina and Tennessee.

The income tax laws of the past eight years may be grouped into two classes, on the basis of their scope. In one group are those laws which apply to incomes of every sort, as in Wisconsin and New York. The former state has one general income tax law, the latter has enacted separate acts for the taxation of individual and corporate incomes. The other group, comprising all other states having income tax laws, have applied these laws to a limited class of incomes. In Massachusetts, Oklahoma, Delaware and Missouri, the tax is levied on the income of individuals only, and in Massachusetts the scope of the law is further confined to certain classes of individual income. West Virginia, Connecticut and Montana levy the tax upon corporate incomes only. *Harley L. Lutz. Report of the Special Joint Taxation Committee of the 83d Ohio General Assembly. 1919. p. 88*

The Special Joint Committee on Taxation and Retrenchment was instructed by joint resolution to investigate and report on the possibility and the methods of securing retrenchment in governmental expenditures, especially in the cities and counties. It was found that the running expenses of state and local government in the state of New York for 1918 were $436,000,000. For 1920 the figure cannot be below $500,000,000, or approximately $250 for the average family of five. It was also found that of this total the expenses of the State government were 17 per cent, the remaining 83 per cent being the costs of city, village, town and county government.

The causes for this marked increase in the costs of city government in this State are:

1. The very rapid increase in the appropriations devoted to education.

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2. The extension of government into new fields of activity, such as parks, playgrounds, nursing, Americanization, health education, etc.

3. The need for extended city improvements partly to make up for the long period of inactivity during the World War and partly to meet the new standard of service and equipment demanded of the city by the people.

4. The expansion of municipal services, such as fire and police, to render more and better service in response to popular demands.

5. The "enthusiasm and desire of department heads to render greater service" and to expand their departments—as Mayor Stone of Syracuse put it.

6. The change in the value of the dollar and the new price level, or as Mayor Wallin of Yonkers stated it: "You are going through a period of increased expenditures as expressed in dollars but not an actual increase when you consider the value of the dollar."

7. Inappropriate and poorly functioning governmental organization.

8. Inefficiency and waste. *Report of the Special Joint Committee on Taxation and Retrenchment. New York. 1920. p. 15-16.*

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AFFIRMATIVE DISCUSSION

INCOME TAX [1]

The taxation system of Michigan is based on an ad valorem general property tax, administered at a uniform rate, on all property not specifically taxed, or by law exempt.

The individual who studies the taxation problems of Michigan with the statistics of recent years before him, cannot fail to be impressed with the importance that must be given to four general conditions, in any solution that may be suggested:

First, the great increase in, and broadening of, the purposes for which taxation is now levied, and the necessary accompanying increase in the volume of taxation;

Second, the continuous narrowing in the base sustaining taxation;

Third, the changes that have taken place in the character of property since our present taxation system was adopted, and the failure at the present time of the ad valorem general property tax to reach and equitably tax all property;

Fourth, the relative importance now held by a class of citizens whose income is the result of personal effort and not drawn from capital represented by any form of property.

Expanding Demands for Revenue

In the year 1909 the total amount of taxes levied in Michigan under the ad valorem general property tax law for all purposes —state, county, school and municipal—was in round numbers \$34,879,000; in 1917 it had increased to \$73,612,000; in 1918 to \$85,132,000; in 1919 to \$110,776,000. The records for 1920 have not yet been compiled, but from the reports that have reached the office of the Board of State Tax Commissioners it is certain that for the present year it will exceed \$125,000,000. It must be borne in mind that these sums do not include taxes paid by

[1] Eleventh Report of the Michigan Board of State Tax Commissioners and State Board of Assessors. 1920. p. 25-46.

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public utility corporations into the primary school fund, or the automobile tax paid into the highway fund, or inheritance taxes, or mortgage taxes, the total of which for the year ending June 30, 1920, was $14,771,746.

The following table, comparing taxes levied in 1909 and 1919, shows an increase in each total in which taxes are classified:

ASSESSED VALUATION AND TAXES LEVIED IN THE STATE OF MICHIGAN

	1909	1919
Real Estate	$1,315,627,624	$3,515,143,380
Personal Property	371,528,073	988,837,601
Total	$1,687,155,697	$4,503,980,981
State Tax	$5,929,304.89	$17,432,512.04
County Tax	4,499,690.06	11,685,086.15
Township Tax	1,150,268.21	2,101,786.11
School Tax	7,186,799.35	29,753,423.09
Highway Tax	3,014,344.94	8,658,775.66
County Road Tax	741,868.05	5,124,191.47
Drain Tax	267,628.51	860,758.73
City Tax	10,791,845.46	31,587,226.22
Village Tax	1,291,173.47	3,557,909.69
Rejected Tax	6,170.26	14,436.94
Total Taxes	$34,879,093.20	$110,776,106.10
Average Rate per $1,000	$20.67	$24.60

This continuous tremendous increase in the volume of taxation is not, to any appreciable extent, the result of waste, extravagance or mismanagement and is due, only in part, to the increased cost of living. Rigid economy, consolidation of Boards, efficient budget administration, undoubtedly will accomplish saving. There will be, also, saving through recession in prices in the course of readjustment from war conditions; but in considering this factor it must be recognized that for years to come, prices will continue on a considerably higher plane than in the past.

The relief which we may expect from readjustment in prices and saving in administration, will, we believe, be more than swallowed up by constantly increasing expenditure resulting from the continuous increase in, and broadening of, the purposes for which taxation is now and will be, in the future, levied. The state, the counties, the municipalities, even the smallest local communities, have entered upon projects of development, especially with respect to highways, streets, sewers, schools, public buildings, parks, etc. that will continue to require increased millions for years to come. These projects of development, it should

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be noted, are financed, only partially, by present day taxation. The main reliance is upon bond issues drawing comparatively high rates of interest, and in the future the interest upon these bonds, as well as the principal as it matures, must be added to the annual tax levy.

Expense, that is reflected in the annual tax levy, follows development in lines that are purely industrial or commercial, and in no way connected with any public business. For illustration, note the cost to the public of automobile development. The state-wide program of highway improvement, now calling for an annual outlay of millions of dollars, owes its rapid advancement and present importance very largely to motor-vehicle development. The cost of constructing improved public highways has been increased to three and four times the cost when only horse-drawn vehicles used the highways. The cost of maintenance after construction, as compared with cost in former years, has increased in the same ratio. The cost of public safety and administration of justice has been increased because of traffic policemen, motorcycle squads, recovery of stolen machines, and the combating of new forms of crime practiced by the auto bandit. The automobile carries the sportsman and the seeker after health and recreation, surely and in ever increasing numbers to the new and more remote parts of the state, putting an increased burden upon the highways, and increased pressure upon public lands suitable for resorts, and upon the resources of our streams, lakes and game fields. All this will call for increased appropriations for the establishment and maintenance of public parks and game refuges, for fire protection, for game protection, and for the propagation and distribution of game and fish.

The requirements of various state institutions, especially those concerned with education, public health, safety, and welfare, always have been generously met and, because of the nature of the appeal they make, will continue to receive favorable consideration. To appreciate the increase in the demands of state institutions, compare the totals now declared to be indispensable with the sums required by these institutions a few years ago. Note also that the increases asked for at this time are not only those made necessary because of increased cost of living and increasing population, but they extend to new plants and new outfits declared necessary because of modern theories of

construction, sanitation and management, and if not now granted must be in the near future. Note, also, that these conditions are not confined to state institutions but extend to those of the counties and cities as well.

Another condition that is increasing, directly and continuously, the volume of taxation is the tendency of the various political units of the state to take over, as proper and necessary functions of government, a large group of subjects relating to both public and private welfare that, until a few years ago, were left entirely to private initiative and private philanthropy; or, if in operation at public expense, functioned only in a limited way. These subjects range from the visiting nurse and public playgrounds for children, to tuberculosis hospitals and mothers' pensions for adults. They relate to public health, sanitation, comfort, recreation, child welfare and any number of kindred subjects. They increase in number and scope every year, and each new feature taken over calls for and justifies the development of some other feature of public or private welfare at public expense. No one will see, or should wish to see, these new functions of government restricted. The world is now in a new orbit and one of the forces that will tend to keep it balanced in this new orbit is a proper and continuous development in public and private welfare through public expenditure, and this condition necessarily means a continued increase in the volume of taxation.

The second condition to which we have referred—the continuous narrowing in the base of taxation sustaining this enormous constantly increasing volume of taxation—is also operating as certainly, as continuously and as efficiently as is the condition of constantly increasing volume of taxation.

Contracting Basis of Taxation

The base of taxation in Michigan is the ad valorem general property tax law. Contemporaneous with its enactment by the Legislature, that body began the process of cutting away, through the granting of exemption from taxation, and it has continued the practice down to the present day. The laws exempting property from taxation are being constantly added to, and they have a tendency to widen in their application, and they, more and more, exempt property not contemplated to be

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exempted by those originally responsible for such legislation. The exemption of so much of the taxable credits of a taxpayer as can be offset by his debits, without regard to the character of the debits and whether taxable or not, is a particularly vicious form of tax exemption. Through the mortgage tax law we are continually creating non-taxable credits by a single payment of five mills. For the debtor in the same transaction these non-taxable credits are legal offsets continuously, year after year, against money, accounts, unsecured notes or other forms of credits subject to taxation at the full rate of the general property tax. The narrowing in the base of taxation through exemption of property from taxation is measured by hundreds of millions of dollars.

Home rule and municipal ownership of public utilities is rapidly and to an alarming extent narrowing the base of taxation. Not many years ago municipalities confined their efforts in the public utility field to such necessary public service as did not attract private capital, such as a municipal water system and public lighting. Private investment in public utilities was encouraged and became a fruitful and constantly increasing source of public revenue through taxation. Now, all is changed and such services as private lighting, power, heat and transportation are considered public functions and are being established under municipal ownership, and a tendency to take over activities of this character now in private ownership is increasing everywhere. The city of Lansing has taken over the Michigan Power Company, and because of such action more than $800,000 in valuation dropped from the assessment rolls of the city. When the city of Detroit takes over or forces from her streets the Detroit United Railway, approximately $30,000,000 in valuation will disappear from the tax rolls of that city. There is hardly a municipality in the state that is not contemplating the taking over or development of some form of public service now in private ownership. We are not regretting municipal ownership of public utilities. We are simply pointing out the inevitable effect the working out of the principle is having upon general taxation. The enactment of state and national prohibition cut a big slice from the base of taxation because of the disappearance of property that was formerly directly employed in the liquor business, and because of the depreciation in value

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of property still in existence, such as breweries, warehouses and personal property. Here, again, we are not arguing the question of prohibition but pointing out how it is affecting taxation.

The most pronounced, the greatest numerically and most to be regretted narrowing in the base of taxation is that which has resulted from the failure of the general tax law to reach intangible property. Taxation of intangible property at a uniform rate with other property has always been the weakest spot in every general property tax system, because the locating and valuing of such property is always difficult and generally impossible without the cooperation of the owner. That cooperation is not always sought and is given rarely; the owner justifying himself in the concealment of such property on the ground that his certificates or securities are but evidence of his participation in the ownership of tangible property already taxed, or on the ground that the uniform rate of taxation, applied to such property, would confiscate income, as would often be the case with savings deposits and securities drawing a low rate of interest; the result being that practically all such property escapes taxation except such as is in the hands of the ignorant or the helpless.

Economic and Social Evolution

Failure to locate and tax intangible property made little difference in the early days of Michigan when the ad valorem general property tax system was established. At that time agriculture was the principle industry. Property was homogeneous, consisting mainly of real estate and tangible personal property dependent upon the ownership of real estate. There was very little intangible property. Wealth was distributed comparatively even, the range of investments was narrow, earnings, and profits were generally converted into property of the same nature as that which produced them. But a wonderful change has taken place in recent years in the character of property, brought about largely through the operations of what may be declared the greatest instrument of modern commercial life—the limited liability corporation and its accompanying secured debt feature, through which an individual may invest in any business wherever located and hazard only his orginal investment, his interest represented by intangible securities easily transferable. The resulting commercial and industrial expansion

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has been almost beyond comprehension. Agriculture has been displaced as the leading industry. The homogeneous character of property has disappeared and, instead, it is now widely diversified. Many new forms of property have been brought into existence as a result of invention, commercial and industrial development, and legal and corporate contrivance. Income has increased greatly, and is derived from numerous and often entirely new sources. It is, for the most part, no longer reinvested in the business which produced it, but seeks investment in intangible and, wherever possible, non-taxable securities. To appreciate the extent to which profits that are fluid are passing into intangible, non-taxable investments, one has but to glance over the columns of any metropolitan daily newspaper and notice the offering of new securities. Today, a very considerable portion of the wealth of the state is in intangible property, and failure, at this time, to properly tax the owners of such wealth, whether as a result of legislation or administration, relieves many from all taxation.

Rise of Professional and Salaried Class

At the same time, and largely as a result of industrial and commercial expansion, a class of citizens has been developed in every community whose income is not derived from capital represented by property, but from salaries, from earnings as professional men, and from particular kinds of business that are being daily brought into existence. This class is generally well educated, and requires more from society and government than the average individual requires. But the general property tax fails to reach this class of citizens, they contribute little through taxation, either for the support of government or the development of social welfare.

Real Estate Bearing the Taxation Burden

The accumulative effect of all these conditions:—a constant increase in the purposes for which taxation is now levied; a constant increase in the volume of taxation; a constant narrowing in the base of taxation through legislation and administration; changes in the character of property, due to commercial and industrial development, and in the comparative wealth of individual citizens; failure of the general property tax to reach intangible property at a time when such property

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is increasing faster than any other form of wealth and is absorbing the profits of all kinds of business; the rise of a highly prosperous class whose income is not drawn from property but from individual effort and from new and strange forms of business, has produced this inevitable result; that practically all the increase in the tax burden falls upon tangible property, which is mainly real estate; and heaviest of all upon that form of real estate which, because it is visible and easily valued, is always highest assessed, the farm and the home.

This condition—that under our general property tax law real estate must inevitably stand practically alone in bearing the increased burden of taxation arising out of new social and economic conditions, has not been appreciated in the past because of the universal undervaluation of all property assessed for taxation. But now that the assessment of tangible property is very close to cash value throughout the state, continued increase in assessment, sufficient to keep the rate of taxation from mounting, will no longer be possible; and the ad valorem general property tax, as the only base of taxation, will be clearly recognized to be unfair and unequal, as exempting many from all taxation, and as falling with the greatest force upon those least able to pay.

Futility of Remedies Proposed

The change in the purposes for which taxation is now levied and in the character of property, and the shifting of the burden imposed by new social and economic conditions upon real estate, have not been unnoticed, and attempts to remedy this situation have been made by the Legislature at different times. But because of a desire to maintain as far as possible the general property tax and because of the constitutional limitation imposing a uniform rule of taxation, such attempts have been limited to the substitution of specific taxation for the general property tax upon certain forms of intangible property; the mortgage tax is an illustration of the attempts of the Legislature to reach intangible property with some form of taxation.

Can we further amend or so administer the general property tax law as to overcome the opportunities for concealment and enable us to locate such property, and derive from its taxation revenue in any way proportionate to the amount of such property,

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taxable in the state? The experience of other states that have had the same system of taxation and the same problem to solve, and that have attempted to reach this class of property by drastic measures, has been universally the same. They have either failed to locate any considerable amount of such property or it has again disappeared after having been once located and taxed. We cannot take away from the owner the state of mind that justifies concealment, namely,—that taxation of such property is unjust in theory and confiscatory of income in practice. We cannot destroy the opportunities that exist for concealment of such property. We cannot in all cases convince the assessing officer that such property exists and should be taxed, and that it is his duty to find and tax it. A Judge of the United States Court of Appeals in commenting upon the taxation of intangible property under general property tax laws expressed himself as follows: "There is a monotonous uniformity in the reports of the failure of every system attempted. However stringent may be the legislation, or however arbitrary and despotic may be the powers with which the assessors are clothed, the result is that always and everywhere no appreciable part of such intangible property is reached by laws however ingeniously framed or severely enforced."

If we continue attempts to apply the ad valorem general property tax law, as now framed and amended, to intangible property, and should, through the application of drastic methods, reach any considerable degree of success, what permanent increase in revenue would result? In the first place, the laws of our state exempt from taxation stocks and securities of Michigan corporations whose tangible property is taxed in the state; therefore the individual whose intangible property is all of Michigan origin would pay no direct tax, regardless of the amount of his wealth. Next, the mortgage tax law, now extended so as to include bonds of foreign governments and municipalities, and all forms of secured debts, makes such property exempt from taxation for all time on the payment of a single tax of five mills. If this law be not repealed, the individual whose intangible property has once paid the five mill tax will thereafter pay no direct personal tax. If the law be repealed and all such property brought again under the general property tax, all present holdings of such property that have paid the five mill tax would

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still remain exempt. Again, the large and growing class of citizens who have little property, but enjoy large salaries or large incomes as the result of personal effort or professional service, and who receive more than the average citizen from government, would pay no tax. There would remain only those having deposits in banks, unsecured debts, and certificates of stock in foreign corporations, to be reached by the general property tax. There are more than $1,000,000,000 on deposit in Michigan banks, but no bank official can be compelled to disclose the names of his depositors, or the amount of their balances. The state of Connecticut once attempted to compel such disclosure for the purposes of taxation, and had it not been that the strong insurance companies of Hartford had millions of dollars available for deposit, every bank in that state would have failed over night. As for certificates of stock in foreign corporations, should we once succeed in reaching them, they would seek safety in concealment before the next assessment. We can see but little permanent relief to real estate from the most successful administration of the ad valorem general property tax law applied to intangible property.

A solution of the problem of taxing intangible property is sometimes attempted by classifying such property and imposing different rates upon different classes—a low rate upon savings bank deposits, a somewhat higher rate upon bonds and mortgages, and still another rate upon more profitable classes of intangible property, the assumption being that by lightening the burden, the owners of such property will cease to conceal it and it can be made to yield some revenue. The State Tax Commission in its report to the Governor in 1914 recommended changes in our tax laws so as to allow classification of intangible property. The experience of other states where classification of property is practiced shows that even in such form the law is persistently evaded. The opportunities for concealment still remain. The belief of the taxpayer, that such form of taxation is double taxation and consequently unjust, still remains. Classification of property would require a constitutional amendment, and the experience of other states shows it to be almost impossible to convince the voters that intangible property, if directly taxed, should be taxed on any other basis than general property. The farmer assessed $5,000 on his farm and paying $100 in taxes upon

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the same would not vote that the owner of a $5,000 bond or stock certificate should pay only $25 in taxes.

How then can we remedy taxation conditions? How broaden the base of taxation? How introduce universality and equality of burden into our taxation system and at the same time increase revenue to meet the new social and economic conditions?

Fundamental Principles of Taxation

Students of tax legislation recognize three fundamental principles as more or less developed in the taxation systems of the various states, which, taken together, conform to all requirements of a model taxation system:

First, that tangible property of whatever character and by whomsoever owned should be taxed by the jurisdiction in which it is located because of benefits and protection there received;

Second, that every person having "taxable ability"—and by that we mean "who is able to pay"—should pay a direct personal tax to the government under which he is domiciled, and from which he receives the direct personal benefits and protection that government and society confer:

Third, that business carried on for profit in any locality should be taxed in that locality because of benefits and protection there received.

Tangible Property Taxation

The first proposition—that tangible property, whether real estate, livestock, machinery, merchandise or raw materials, should be taxed where located regardless of ownership has always been accepted by the lawmakers of Michigan without reservation, and is now developed, in practice and legislation, by the experiences of more than three-quarters of a century. Those experiences, we believe, make it certain that this principle should not be modified as far as real estate is concerned, except as to forest property. With respect to tangible personal property, we recognize that there may profitably be departures from it in certain cases, such as the substitution of specific taxation for the general property tax with respect to motor-vehicle property. We also recognize that where the second and third propositions above outlined are fully developed, certain kinds of tangible personal property, such as tools, implements, live-

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stock, may properly be exempted in whole or in part from the operation of this first principle, but the principle itself should stand practically without amendment.

Direct Personal Taxation

The second proposition—that every person having "taxable ability," that is, "able to pay," should pay a direct personal tax where he is domiciled—while equally as just and logical as the first proposition, and as widely recognized, has been practiced far less successfully. It has been attempted through poll taxes, rental taxes, taxes upon professions and occupations; but the more general practice has been to attempt it by making "intangible property owned" the measure of the individual's "taxable ability," and assessing him for such securities and credits as he might declare, or the assessor locate. Michigan has adopted this method and includes all kinds of intangible property under the general property tax, applying the uniform rate, and has only in recent years modified it by the adoption of the so-called "Mortgage Tax Law." She has recognized the principle of direct personal taxation, but has destroyed its vitality by her method of enforcing it.

Net Income the Unfailing Index of Taxable Ability

The most universal, the most complete and the most accurate measure of the ability of the individual to pay personal taxes is "net income." "Personal property owned," correctly determined and expressed in dollars, will measure the taxable ability that comes from the ownership of certain kinds of wealth, such as securities and credits. "Net income" will measure such wealth equally as well, and will measure "taxable ability" resulting from the earnings of the salaried man, the professional man, the business man, the laborer; it measures "taxable ability" resulting from rents and royalties, and introduced into a system of taxation, it materially broadens the base of taxation.

Adam Smith, years ago, laid down this proposition: "Subjects of every state ought to contribute to the support of the government as nearly as possible in proportion to their respective abilities; that is,—in proportion to the revenue which they respectively enjoy under the protection of the state." Other students of taxation, holding that taxes are the part of the citi-

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zen's property or earnings he contributes for public use in order to insure protection for the rest of his property or income, have supported Adam Smith's proposition that taxation should be proportional; declaring that as protection or benefit received is proportional to the amount of property protected or income enjoyed, it necessarily follows that taxation, to be equitable, must be directly proportional to property or income. Most modern writers, while not objecting to proportional taxation of tangible property, hold that direct personal taxation, through an income tax, should not be proportional, but progressive. Even Adam Smith modified his famous principle by declaring: "It is not unreasonable that the rich should contribute to public expense not only in proportion to their revenues but something more than proportion." Practically all agree that it is not wise to exact a personal tax for support of government from any class, if by so doing the standard of living of that class is necessarily reduced below a proper level, and therefore exemption from any personal tax is recognized as proper for those whose net income does not exceed the sum recognized as the minimum necessary for proper subsistence. This exemption is a departure from proportional taxation. Protection or benefit resulting from taxation is not the only thing that should be considered,—there is also the sacrifice involved in paying the tax, in giving up for public use something that would otherwise be made use of to satisfy personal wants. It is the right of every individual to make use of all his income in satisfying his wants, and any restriction of the power to do so necessarily involves sacrifice on his part. Personal taxation in the form of taxation of income, therefore, involves sacrifice of some of our wants. But our wants are not all equally pressing and the sacrifice required in giving up comforts that border on actual necessities of life is much greater than is the sacrifice that does not involve giving up any comforts and only the more extreme luxuries of life. Proportional taxation, the requiring everyone to pay the same rate of income taxation, gives no consideration to the inequalities of sacrifice required as between incomes of different amounts. True equality in income taxation should consider the sacrifice involved as well as the benefit received and not require that the same rate of taxation should be paid by all, but that rates should be so arranged as to require, as near as possible, the

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same degree of sacrifice from all. Actual and complete equality of sacrifice is of course impossible of attainment. But by imposing a low rate upon small incomes and increasing the rate as the income increases, by making the income tax graduated or progressive, whichever you choose to call it, we can secure relative equality of sacrifice.

A personal income tax, with exemptions sufficient to enable the individual to maintain a proper standard of living, and with rates of tax graduated so as to equalize as far as possible the sacrifice imposed, is the fairest, the most equitable, and the least oppressive system of taxation as yet devised, and the only system that will reach those whose wealth is in intangible property, and those whose income is derived from personal effort.

Justice and Equity of Income Taxation

The justice and equity of the graduated income tax is shown by the fact that it conforms at all times and for all classes to the principle of "ability to pay." It not only relieves those with little property from heavy burdens, but also, in the case of those with large wealth, it responds to the variations in individual conditions that occur with all citizens from year to year. An individual may be highly prosperous one year and have little income the next year without any apparent change in the amount of property owned. The general property tax is merciless in its exactions and is regardless of conditions, but the graduated income tax responds to such conditions. The progressive income tax never confiscates property, but the general property tax confiscates hundreds of thousands of dollars worth of property every year.

Great Scope of the Income Tax

The justice and equity of the progressive income tax is further shown by the fact that it reaches officials, professional men, and certain classes of business men who escape entirely the general property tax. Of such it is the truth to say that their gains are comparatively large. They live in style and comfort. They enjoy the protection and benefits of government and society without contributing directly to its support. They are also, as a class, well educated and well informed, but by reason of being untouched by taxation they have little concern as to

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public business, and are apt to become indifferent to their duties as citizens. The bringing of this class into the group of taxpayers is a distinct public gain from more standpoints than that of revenue.

Practically all political economists recognize the justice and equity of income taxation as a theoretical proposition. Those who oppose it generally do so on the ground that it fails in practical operation, and cannot be administered on the high plane claimed for it; that it is inquisitorial in character, and hence not suited for democratic governments; that it is socialistic; that it is a tax on brains, energy and industry; that it invites perjury and evasion; that, in the past, it has failed as part of a state taxation system and responded neither to the demands of justice nor the needs of revenue.

Previous to 1903, sixteen of the states of the Union had attempted income taxation in some form, but on that date only six of the states were continuing such attempts. The failure of these early attempts was due, in part, to defects in the laws themselves, which were generally special taxes upon income from particular sources and rarely a general tax upon net income; but, chiefly, the failure was due to the utter inefficiency of their administration. In respect to both legislation and administration, these early attempts at state income taxation are no more to be compared to the modern state income tax systems, such as are now administered in Wisconsin, New York, Massachusetts, Missouri, Oklahoma, and other states, than the old street cars drawn by horses or mules are to be compared to the modern municipal transportation system.

Income Taxation the Great Barrier to Socialism

The argument that the income tax is inquisitorial and undemocratic is absurd and unconvincing. What tax system efficiently administered is not inquisitorial? The general property tax is inquisitorial, especially when applied to personal property. Under it the assessing officer is authorized to demand from the taxpayer a full statement of all his property, money, credits, debts, securities, even the jewels and adornments of his family. The tariff tax is inquisitorial. You must declare every article you bring into the country and its cost, and this does not give immunity from personal examination of your possessions. The

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internal revenue tax in its entire administration is inquisitorial. If tax laws are not inquisitorial and not administered in that way, they are evaded more or less, and honest men suffer and dishonest men gain. If we do not repeal the general property tax as far as it applies to intangible property, and if we are to have any degree of success in enforcing that tax, we must administer it in the most inquisitorial manner. The fact that tax laws not administered in an inquisitorial manner are continually evaded is not due to the particular character of the tax, but to the nature of taxation itself which is "sacrifice without glory' or even without recognition of the sacrifice, and human nature has not yet reached the point where it does not try to evade such form of sacrifice. To condemn the graduated income tax because it endeavors to prevent evasion, compels us to condemn efficient administration of all tax laws. John Sherman, former Senator from Ohio and Secretary of the Treasury, speaking on this question, said: "The income tax is the least inquisitorial and injurious of all taxes imposed by government and is the one tax that falls upon office and upon brains."

The further claim is made that the income tax cannot be efficiently administered without causing capital to seek immunity by withdrawing from the states enforcing such a tax. The refutation of this claim is found in the attitude of the states administering a present day personal income tax, such states as New York, Massachusetts, Wisconsin, Missouri and Oklahoma Not one of them, after experience with this form of taxation. has any thought of repealing its income tax law or of changing it other than to make it more inclusive. New York and Massachusetts are especially the home of capital, and would be materially injured if capital actively resented the imposition of a state income tax. This argument is further refuted by the reports of the commissioners or officials charged with administering income taxation. In Wisconsin, for instance, the amount of the income tax levied increased from $4,145,676 in 1914 to $11,784,151 in 1917, a condition which would not exist if wealth were not increasing at a tremendous rate within the state, instead of being driven from the state. This contention is also refuted by the fact that half a dozen state Commissions, after studying the operation and effect of state income taxation in recent years, have reported, or are preparing to report, at

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an early date, to their respective Legislatures favoring an income tax system for their respective states. As an instrument for driving capital from a state, the income tax is not to be mentioned in the same breath with the ad valorem general property tax upon intangible property efficiently administered.

The argument that the income tax is inquisitorial and cannot be successfully administered is often supplemented by the charge that it is "socialistic" in character. Why it is any more socialistic to tax a man on his net income than it is to tax the particular property producing the income is difficult to see. Graduated income taxation might be called "socialistic" if its avowed purpose or actual result was to aid in bringing about such economic results as the more even distribution of wealth or the confiscation of private property; but such is not the purpose or the result. The equalizing of sacrifice imposed by taxation is as necessary to exact justice as is the granting of equal rights and equal opportunities. Many who would scorn to be classed as "socialistic" contend that taxation may properly fill an economic or social role as well as a strictly revenue role. Protective tariff laws are not framed for revenue alone, but for the added and openly avowed purpose of aiding industrial development and individual prosperity. Sumptuary laws often have the avowed purpose of checking consumption as well as the production of revenue. Other taxes are equally open to the charge of being socialistic. The general property tax, in that it affects only property owners and is always loaded down with exemptions, is socialistic. Inheritance taxes are still more open to the charge of being socialistic. The cry "socialistic" has many times been used to impede social reforms that have been successfully inaugurated in spite of such opposition. This cry was used against child labor legislation, against mothers' pensions, just as it is now used against progressive income taxation. If we continue to run from social reforms, and decline to undertake economic reforms at the cry "socialistic," we will assist the Socialist Party in its campaign for true socialistic doctrines, with which we have no sympathy.

Comparison of Federal and State Income Taxation

Objection to the personal income tax will come from those who do not understand the difference between the proposed

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state income tax and the existing Federal income tax. The Federal income tax is new taxation designed to collect a very large revenue, made necessary by war-time expenditures of the government. It does not displace any existing taxation. It is not designed to equalize taxation. It is a revenue measure, solely, and, for that reason, is loaded down with high rates of taxation, excess profits taxes and many features of administration that are exacting in character and annoying to the taxpayer. The proposed state income tax, on the other hand, is intended as a substitute for that part of our present taxation system which fails in operation. Its purpose is *equalization* of taxation rather than *increased* taxation. Millions of increased revenue must be raised in any event and to raise it through income taxation will not increase the burden of those now contributing their proper quota; it will come from those now escaping taxation. The state personal income tax should be simple, easy to administer, with no excess profits taxes and the highest rate not exceeding 8 per cent.

Immediate Action Necessary

There is a disposition on the part of taxpayers to endure conditions with which they are familiar rather than to substitute for them other conditions with which they have had no experience. There is the feeling on the part of many people that the country is now going through a period of readjustment, in the course of which the program of Federal taxation may be radically changed. There are some who suggest alternative propositions for the state income tax, such as a refund by the Federal Government to all the states of a fixed per cent of the income tax collected in each state; or the levy of a surtax upon the Federal income tax by such states as desire state income taxation. Both alternative propositions could limit the actual administration of all income tax legislation to officials of the United States Government. The proposition of a refund to the states by the Federal Government would also result in uniform tax rates and uniform methods of administration throughout the United States. All holding such views argue that we should delay entering upon the solution of our taxation problems. With this

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sentiment we have no sympathy. Income taxation, for state and nation, has come to stay. The operations of the Federal income tax have made the people familiar with the principle of income taxation, and the question of introducing this principle into our taxation system should in no way depend upon the rates of the Federal income tax or the amendment of its excess profits tax features. Thirteen states have adopted some form of income taxation. We have the legislation and practical experience of these states to guide us. Other states have studied the question and the results of their investigations are available for our information. The taxation problem of Michigan is now acute in every political subdivision of the state. Action to replace the present unenforcible law for the taxation of intangible property, with a law that will reach such property is imperatively demanded at the earliest possible date.

ADVANTAGES OF THE INCOME TAX[1]

The income tax reaches everyone in accordance with his ability to pay. It is the one tax that will most fairly and equitably reach the professional and salaried men who earn large incomes. They now entirely escape taxation except on such property as they may have accumulated and which very obviously is no fair indication of their ability to contribute to the support of government.

This is likewise true in respect to the great wealth, represented by the securities and credits of all kinds and by various forms of intangible property, which is now escaping taxation. One of the most interesting facts to be gained from a study of the Wisconsin results is, that the classes of occupations, of professions and of property-owners that most successfully escape in New York, are the very ones that pay the larger part of the Wisconsin tax levied upon firms and individuals. In New York State the following classes are able to escape taxation in a large degree: Bankers and capitalists, brokers, lawyers, merchants and jobbers, manufacturers, physicians and surgeons, and other professions.

[1] Report of the Joint Legislation Committee on Taxation of the State of New York. 1916. p. 195-206.

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We quote in this connection from the Report of 1914, which reads as follows:

Occupation	Number assessed for income tax	Average tax per taxpayer	Per cent of total income tax	Per cent of total number assessed	Per cent of total taxable income
Bankers and capitalists........	982	$116.33	8.00	1.61	4.76
Estates, guardianships, etc.....	977	82.42	5.98	1.60	3.76
Lumbermen	346	81.27	1.97	.57	1.32
Manufacturers	2,920	78.26	16.01	4.80	11.36
Lawyers	1,202	59.26	5.02	1.97	4.18
Miners	80	38.89	0.22	.13	.18
Retired	3,263	37.24	8.51	5.36	6.93
Merchants and jobbers	11,838	24.13	20.01	19.45	23.55
Physicians and surgeons	1,642	22.78	2.62	2.70	3.30
Brokers, real estate men, etc..	5,338	20.86	7.80	8.77	8.72
Public officials	555	16.05	0.62	.91	.93
Mechanics and tradesmen	5,768	12.63	5.10	9.48	6.17
Professions—miscellaneous	2,359	12.30	2.03	3.88	2.96
Professors and teachers	2,372	10.40	1.73	3.90	2.08
State and public employees....	1,203	8.15	0.69	1.98	.99
Public service employees	2,870	7.96	1.60	4.72	2.07
Farmers	7,225	7.66	3.87	11.87	6.40
Bookkeepers, stenographers, etc.	4,148	4.96	1.44	6.82	2.54
Laborers	882	2.91	0.18	1.45	.34
Other occupations	4,336	20.25	6.15	7.12	6.78
Unknown	554	11.71	0.45	.91	.68
All occupations	60,860	23.46	100.00	100.00	100.00

Certain important conclusions may, however, be drawn with safety. For instance, the census statistics make it plain that there are not less than one hundred sixty-five thousand farmers in the state, from which it follows that certainly less than 5 per cent of the farmers of the state are subject to the income tax. Similarly, it is certain that considerably less than 1 per cent, and probably less than ½ of 1 per cent, of the laborers of the state are assessed for income taxes. Of the bookkeepers, stenographers and clerks, the statistics indicate that something less than 6 per cent were assessed for income tax in 1914.

On the other hand, it is practically certain that more than 50 per cent of the bankers and capitalists, lawyers and physicians and surgeons were subject to the individual income tax, to say nothing of the amounts which these persons pay indirectly through the tax on corporations. It is interesting also to note that probably not less than 20 per cent of the public officials, public employees and public laborers of the state were assessed

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for income tax. The federal census for 1910 shows 7,338 employees in the public service, not elsewhere classified, including guards, watchmen, doorkeepers, firemen and laborers. Table IV shows that 1,758 public officials and employees were assessed for income tax in 1914, or somewhere between one-quarter and one-fifth of the number recorded in the census. There cannot be a very large number of public employees classified elsewhere than in this group.

Perhaps as good a measure of the relative burden of the tax as could be secured is found in the figures showing the average tax per taxpayer. The various occupations are arranged in the order of the size of this average tax in Table VI. The highest per capita tax, $116.33, is paid by bankers and capitalists; the lowest by laborers, $2.91. The tax was evidently highest upon investors and allied classes, those drawing their incomes largely in the form of interest. Next it touches the extractive and manufacturing industries—lumbering, manufacturing and mining—though it should be remembered that in these classes a relatively large proportion of the tax is offset by the personal property tax. Merchants and jobbers follow closely, among whom also a large part of the tax is offset by personal property taxes, and thereafter come the professional classes. The lawyers it will be observed are above the other professional classes, standing between manufacturers and miners. The tax on the professional classes generally is additional or supplementary. It is not offset by the personal property taxes and no equivalent tax was collected from these classes before the income tax was introduced. *The statistics indicate that the income tax is performing exactly the service for which it was introduced—drawing a larger contribution from the investing and professional classes and from those elements of the manufacturing and commercial classes which are usually prosperous and subject to higher income than personal property taxes.*

This conclusion is further emphasized when we remember that the largest accumulations of so-called intangible personal property are found in our great cities, and that the income tax is, strictly speaking, an urban tax. In Wisconsin, the first year, over 40 per cent of the entire tax was charged in Milwaukee County and more than 80 per cent in the seventeen counties having the larger cities of the state, while 20 per cent was

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charged in the remaining fifty-four counties containing about 50 per cent of the population.

The urban character of the tax is shown in another way by the returns from Dane county in which the capital is located. In the county there are six times as many farmers as there are public employees, "yet only sixty-eight farmers in Dane County as contrasted with six hundred twenty-four public employees and professors will pay an income tax; and the farmers will pay an income tax of $877.35, while the public officials, professors and teachers will pay $7,224.44, more than eight times as much."

The income tax is primarily an urban tax. Milwaukee county, for instance, contains only 8.56 per cent of the population of the state, but 42.55 per cent of the total income and 47.12 per cent of the total income tax are assessed in that county. The fifty-four rural counties, on the other hand, contain nearly 50 per cent of the population but pay less than one-fifth of the tax.

The marked urban character of the tax comes out in other relationships. For instance, the total income tax assessed in 1914 amounts to $1.77 per capita. But the per capita tax in Milwaukee City is $4.50, and in the rural counties only 53c. Again, the average rate of taxation paid is 3.61 per cent in Milwaukee County, but only 1.95 per cent in the rural counties of the state. Finally, in Milwaukee County 4.69 per cent of the population is subject to the tax on firms and individuals, while in the rural districts only 1.71 per cent of the population was assessed. In short, a smaller proportion of the people pay, and they pay lower average rates on smaller average incomes, in the country than in the city.

As has already been shown, the property tax falls with the greatest weight on the man of small means, on the widow, on trust estates, on young and struggling business concerns, and, generally speaking, on those least able to bear it. Under the income tax these people contribute their proportion, but their proportion is relatively small as compared with that of the wealthy and prosperous, who enjoy large incomes and are, therefore, better, and with much less sacrifice, able to shoulder the tax burden, and yet who, today, are practically free from taxation, except in so far as they own real estate.

We cite again the Wisconsin results for the purpose of illustrations:

This table contains some very significant data. Of those assessed in 1914 for income tax, 41,732 had taxable incomes under $1,000. This group of small taxpayers constituted 68 per cent of the total number, but paid less than 11 per cent of the total tax. The average tax in this group is $3.74.

On the other hand, 315 taxpayers having incomes of $15,000 or more, and constituting about ½ of 1 per cent of the total number of taxpayers, were assessed for practically 40 per cent of the aggregate tax, and the average tax on each person in this group is $1,794. This group of three hundred fifteen taxpayers constitutes less than 2/100 of 1 per cent of the population of the state. The two upper groups of taxpayers—six hundred sixty-seven in number—constitute less than 3/100 of 1 per cent of the entire population but contributes nearly one-half of the income tax.

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Classified by amount groups of income	Number assessed	Per cent of each group to total	Taxable income	Per cent of each group to total	Tax	Per cent of each group to total	Average tax per individual
Total..........	60,560	100.00	$73,969,905.25	100.00	$1,427,923.13	100.00	$23.46
Under 1,000....	41,732	63.57	15,545,782.60	21.02	156,202.53	10.94	3.74
1,000 to 1,999	10,528	17.30	11,004,276.71	18.93	152,871.09	10.71	14.52
2,000 to 2,999	3,855	6.33	9,210,837.07	12.45	110,348.59	7.73	28.62
3,000 to 3,999	1,691	2.78	5,760,689.61	7.79	75,436.33	5.28	44.61
4,000 to 4,999	908	1.49	4,027,847.48	5.44	57,906.82	4.05	63.76
5,000 to 9,999	1,479	2.43	9,820,371.30	13.28	182,901.61	12.81	123.70
10,000 to 14,999	352	0.58	4,245,486.58	5.74	127,168.00	8.91	361.26
15,000 and over.	315	0.52	11,354,613.95	15.35	565,087.56	39.57	1,794.00

As a further illustration we may give an example of the amount that would be contributed by the highest and the lowest classes of tax-payers under the terms of the bill attached to this report. 72,345 people having incomes less than $3,000 would pay a total of $287,587.15, while eighty-two people having the larger incomes in the state would pay a total of $1,809,649. The result is almost startling, and yet the eighty-two would be paying only their share. But neither for the wealthy man nor for the poor man would the burden be a heavy one, for a low rate running from ½ of 1 per cent to a maximum of 2 per cent on individuals would satisfy all our needs. Under this rate, with an exemption of $1,500 to a single man and of $2,000 to the average family, the family man with an income of $3,000 would pay but $5 per annum, while the man with an income of $100,000 would pay somewhat less than $2,000 per annum. Could either one of them fairly complain? Nor, under such circumstances, would there be any real incentive to escape.

No man will willingly pay a 2 per cent tax on capital value, which amounts to taking from 30 to 50 per cent of his income. Experience has shown, however, that he will pay so reasonable an amount as 2 per cent on income, particularly when he knows that all who should are contributing their share. Under our present system the conscientious tax-payer is not only asked to pay a confiscatory rate, but he is asked to do so with the full knowledge that merely everyone in the community is dodging the tax in one way or another. Most men are honest. Most men, we believe, are willing to pay a fair and reasonable tax, but there is a point in taxation where it is dangerous to test human nature too far, and where the honesty of the average

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citizen is forced to give way to the instinct of self-protection. Turning now to general business corporations and individuals and partnerships engaged in business, we find that in so far as these classes are concerned, the personal property tax is illogical, burdensome, unequal and therefore inequitable; that the great majority of business houses escape taxation, but that those that do pay are taxed at a rate altogether too high, a fact which puts them at an unfair disadvantage as compared with their competitors; that, in brief, the personal property tax is, in the main, a failure, and to the extent that it does succeed, grossly unjust. We find, moreover, that the assessment and valuation of property gives rise to all manner of difficulties, particularly in the case of corporations where it is necessary to include the franchise value as part of the gross assets or of the capital stock value; and that ultimately the assessors find that the fairest way to reach the capital value of the property is through the capitalization of net earnings. Few, if any, of the difficulties arise when individuals engaged in business and general business corporations are taxed on a net-earning basis. As has been well said by Dr. Ely in the report of the Maryland Tax Commission:

> Furthermore, it is of moment that the income tax does not make it more difficult for a poor man to begin business or to continue business. Its social effects, on the contrary, are beneficial, because it places a heavy load only on strong shoulders. Even for men of large means engaged in business it is a tax to be strongly recommended, for such men will in some years make little or nothing, or even lose money. Now, our property tax is merciless; it exacts as much in a year when a business man is struggling to keep his head above water as in a year of rare prosperity; whereas the income tax exacts much only when much can be given without financial embarrassment. If it were practicable to substitute an income tax for the whole of the property tax it would save many a man from bankruptcy. I will repeat, with some modification, in this connection, words I used in my special report as member of the Baltimore Tax Commission:
>
> "It is the fairest tax ever devised; it places a heavy burden when and where there is strength to bear it, and lightens the load in case of temporary or permanent weakness. Large property does not always imply ability to pay taxes, as taxes should come from income; even when assessed on property it is only an indirect device for estimating income. An income tax spares the business man in season of distress and helps him to weather the storm, but asks a return for the consideration shown in days of increasing prosperity."

Moreover, as we have repeatedly stated throughout this report, property is not a fair test of ability to pay, and this is particularly true in the case of merchants and manufacturers. We again desire to emphasize, that the amount of stock of goods on hand or the capital value of the property does not adequately measure earning capacity for the purpose of taxation,

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and that we know of no fairer way of determining what should be the proper contribution of an individual corporation than by considering its net earnings. This is all the more true when we consider that it takes, in some instances, several years for a business to develop to the point that it can pay a return upon the original investment. It is neither good policy nor sound finance to overtax an infant industry, nor, for that matter, even an established industry, in bad times. Taxes are paid out of income, and one of the great advantages of an income tax as a business tax is that it levies tribute only when there is an income from which to pay it. That the income tax is the best way of taxing both individuals engaged in business and general business corporations, was the opinion of practically every business man that appeared before our Committee, and of the Tax Committees of such representative commercial bodies as the Chamber of Commerce of the City of Rochester, of the Merchants Association of the City of New York, and the Chamber of Commerce of the City of New York.

The income tax is the only tax that will reach that great class of people who do business in New York City, enjoying all of its commercial and other advantages on the same basis as a citizen of the state, and who, under the present law, pay no taxes whatsoever.

One of the chief difficulties of our present system is the varying rates in different localities which tend to produce grave inequalities as between towns and between the residents of different towns. The tendency, of course, is for taxpayers to establish a real or fictitious residence in that locality where the rate is lowest, and this inevitably results in injustice to the other less fortunate towns and their taxpayers. By the establishment of a uniform rate throughout the state, the income tax will do away with this situation entirely. "Isles of safety" and favorite places of residence will disappear, and individuals and corporations will all meet on an equal and fair basis, subject to a just burden, and with the full knowledge that it is common to all and that there are neither a fortunate many nor an unfortunate few.

To equalize the burden is the principal function for which this Committee was appointed. Certain classes of property are today paying too much, others too little. No equality can exist until those paying too little are compelled to pay their share

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It seems to us that the income tax meets these requirements. The Committee has caused to be made various estimates as to the possible yield of an income tax in the state of New York. Different methods have been used, and a number of experts have made various estimates based on these different methods. The results in each case are not far apart. All tend to indicate that a corporation tax as outlined in the attached bill would yield in 1916, at a 1 per cent rate, approximately, $9,000,000; at 2 per cent, approximately, $18,000,000; and at 3 per cent, approximately $27,000,000. In the year 1917, at 1 per cent, approximately, $9,000,000; at 2 per cent, approximately, $19,000,000; and at 3 per cent, approximately, $29,000,000.

The estimate of the yield from the individual income tax at the rates contained in the attached bill is as follows:

1916	$18,000,000, approximately
1917	19,000,000, approximately

From these amounts would have to be deducted, however, the present revenue derived under section 182 from the corporations that would be subject to the income tax, which corporations, by the terms of the attached bill, would be relieved from payments under section 182. The state would then, out of the total amount collected, retain a little over $2,000,000, plus the cost of administration; and the balance, under the terms of the bill, would be returned to the localities. This balance, in 1917, would amount to over $44,000,000. In considering the net gain to the localities over the present system, we would have to take into consideration the loss of approximately $6,000,000, at present derived from the personal property tax. After allowing for all these deductions there would still be a net gain of $38,000,000, to be distributed to the localities with a view to equalizing the present burden of taxation by relieving real estate and such other forms of wealth as are now contributing more than their share. We give in the appendix a table showing the amount which would be received by each county if the $38,000,000 were distributed on the basis of the assessed values of real estate for the year 1914. This table shows beyond any question that there is not a county in the state that would not be infinitely better off than it is today.

The suggested method of distribution according to assessed values in each county is novel, but it has these advantages:

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1. It will avoid the difficulty which would arise if each locality were permitted to retain the tax paid by residents of that district. Under this latter method some districts, where many rich men have established a residence, or where many prosperous corporations are located, would have more revenue than they could use, while others, whose inhabitants enjoy smaller incomes, would receive little or no revenue.

2. The new method will tend to encourage the raising of real estate assessments to a point approaching true value.

3. It will meet the criticism made of an income tax to the effect that, although the rate is usually low at the start, there is a constant temptation to raise it in order to obtain more revenue. Under the proposed system there will be no temptation on the part of the Legislature to raise the rate, inasmuch as the state will not profit, while it is hardly probable that all of the localities, or even a majority of them, will unite at one time in demanding an increase, or at least such a situation will not occur unless the increase is fully warranted by the general circumstances.

It is sometimes said that the income tax is inquisitorial, but it will be noted that the bill hereto attached makes it possible for the taxpayer to file with the State authorities a return which is, for all practical purposes, a duplicate of the information already furnished to the Federal government, together with such additional information as may be necessary for state purposes. We hear little or no complaint today as to the inquisitorial features of the Federal income tax. People have become accustomed to it. Nor do we feel that there will be any great reluctance to disclose to the state authorities information already furnished by the Federal government, particularly under a law which provides severe penalties for the disclosure of any information by the public officers.

Again others object to a state income tax on the ground that there is already a Federal income tax. But let us analyze the objection. There is no question that, in addition to the Federal income tax, personal property must contribute its quota to the support of the state government. Is it better to impose a 2 per cent property tax on capital value, or to impose a 2 per cent tax on net income? We can hardly assume that the state will continue to allow the personal property tax to remain on the statute books and to permit its evasion. And so the choice does not lie between no tax and some new form of taxation such as the

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income tax, but between a continuance of the present hopeless system, and some better and more equitable way of raising revenue. If such a latter plan can be devised, are we to reject it because it is already employed by the Federal government, and in order to avoid duplication, continue to tax the same property in a manner which we admit ourselves to be inequitable, and to be a failure?

Finally, it is often said, that while theoretically sound, the income tax will not work in practice. This may have been true prior to the enactment of the Federal Income Tax Law, but this law is of immense help to any state desiring to impose an income tax; and for two reasons. In the first place, many people are already accustomed to it, they understand its workings and will not resist its enforcement; and in the second place, the fact that the Federal government requires a return, and has the machinery to check up that return in a strictly accurate manner, makes the evasion of the state income tax a matter of no little difficulty and danger. In so far as corporations are concerned, the Federal law today permits a state to examine the returns. A similar provision in so far as individuals are concerned, could probably be obtained from the Federal government. But in the meanwhile it seems to us highly doubtful whether any individual having already filed a correct statement with the Federal government would be foolhardy enough to file an incorrect duplicate with the state authorities.

The income tax will work in practice. It has been successfully administered in practically every European country for a great number of years. The Federal income tax works, and the Wisconsin experiment has conclusively demonstrated that with a good administration a state income tax does work. There seems to be, moreover, a strong movement in favor of such a tax throughout the country. Connecticut and West Virginia both adopted an income tax, in so far as corporations are concerned, last winter, while the people of Massachusetts, by a vote of almost three to one, adopted at the last election an amendment which permits the imposition of such a tax in the state of Massachusetts. Practically every witness that appeared before our Committee—and the list included representatives of leading commercial and business organizations, as well as tax experts, business men and individuals from many walks of life—advocated the abolition of the personal property tax and the substitution therefore of the income tax.

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THE INCOME TAX[1]

No question before the Convention is as misunderstood as is this form of taxation. Some oppose it on the ground that taxes are high enough at present, and, consequently, should not be further increased. *This, of course, is a fallacious line of reasoning, and entirely omits those practical aspects of the question that should receive the serious consideration of all thoughtful men. We are not, moreover, attempting to increase taxes;* we are as much interested in seeing them reduced, if possible, as anyone else is; but what we are endeavoring to do is to solve the question of an equitable distribution of the present burdens that the people themselves have voluntarily assumed.

The income tax is defined by Thomas E. Lyons, a member of the Wisconsin Tax Commission, as follows:

> An income tax is a direct levy by a government upon the income of individual citizens whether that income is received from labor, industry, investment, real estate or any other source, computed annually or at stated intervals,—Bliss Encyclopedia of Social Reform, 600. It is in effect a tax based upon and measured by the earnings of person or property, or of both combined.
>
> Income taxes differ from property taxes which are either imposed upon property direct and become a lien thereon, as in the case of real estate, or are made a charge against the person by reason of ownership, as in the case of personal property, regardless of productiveness except as that element may be reflected in market value. They differ from occupation and other excise taxes which are exactions for engaging in particular lines of business or in an ordinary line of business in a particular way; and they differ from consumption taxes, which are measured by expenditure.
>
> Income taxes are not levied upon property nor upon the operations of trade and business, or the persons employed therein; nor upon the practice of a profession or the pursuit of a trade or calling. They are taxes levied upon the acquisitions arising from one or more of these sources. Ordinarily the tax is based upon the excess of such acquisition for a given period over a certain minimum sum called an exemption. They are, therefore, taxes upon the periodical accretions produced by personal effort or from the use or disposition of property or of all these combined.

It is also contended that this is a source of revenue which has been "pre-empted" by the Federal Government, and should not, therefore, be touched by the state. Such a contention has no foundation either in theory or fact. We believe that it is a well understood fact among all tax authorities and financiers that a tax on income is not an independent source of revenue—there can be only one source of revenue, ordinarily speaking, and that is *income,* out of which *all taxes* of whatever nature are

[1] Report of the Louisiana Assessment and Taxation Commission to the Constitutional Convention. 1921. p. 33-48.

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paid—and the income tax is but a method of determining, just as the general property tax attempts to determine, how much each citizen should contribute to the support of the government.

The Assessment and Taxation Commission of the Province of Manitoba, in its report, made in 1919, on that phase of the question in the Dominion of Canada, said:

> The objection taken by some witnesses before this Commission to the adoption of a Provincial Income Tax in Manitoba for municipal purposes, that it would compete with the Dominion Income Tax, and so lessen its productiveness, rests on a singular misapprehension. The sources of tax revenue are not watertight compartments. Every tax, whether Federal, Provincial, or Municipal, imposed directly on the income, taxpaying classes, or indirectly shifted by competition to them, so far tends to lessen the income on which taxation can be levied. For all taxes fall on persons, though in many cases nominally imposed on things; all are in the long run open or disguised income taxes. Indeed most taxes take more out of income than if they are levied directly on it. An income tax in this respect differs fundamentally from a tax on a particular commodity.

In "The Science of Finance," by Professor Adams of the University of Michigan, we find the following:

> Speaking analytically, all taxes must be paid out of income, and if properly understood, out of net income. The word income needs no further definition than that implied in the definition of a tax already given, which asserts that a tax is a derivative revenue. The rent, the royalty, the interest, the dividends, the profit, the salary, the wages—these are all funds which, according to the phraseology of contracts, stand for income. It thus appears that an income is a sum of money which comes in to an individual or corporation during a definite period of industrial activity. We may assume this period to be the year. It is then the amount which during the year will come to be at the disposal of the citizen, and which may be used in current expenditures or in an extension of investments. From the individual point of view, therefore, it is the net income and not the gross income to which the state must appeal. It is the income that limits domestic expenditure, and not the income that measures the volume of business, that must be made the sources of payment to the state. The phrase gross income cannot properly be employed except for a business which has operating expenses. To accept gross income as the measure of the possible expenditures for consumption in any direction whatever has been the first step to the ruin of many a business man. A tax, therefore, whether in the form of an income tax, a property tax, or any kind of a tax whatever, must, so far as the individual is concerned, come from the net income, for the same reason that rent or payment of the grocer must come from that fund. This is in harmony with the idea entertained throughout this treatise, that a tax is, or at least should be, a necessary item in every domestic budget. It is true that a tax may be paid out of the saved income of past years; but such a practice could not be followed very long without ruin, and on this account the contingency is not recognized in the discussion which assumes an annual payment in perpetuity. The revenue of a state must flow from the product of current industry, and in so far as the state permits this product to be distributed among producers before it demands its share (that is to say, in the case of derivative as distinguished from direct revenue) the fund from which this revenue is derived must be a net revenue of citizens.
>
> A tax on income is a very simple tax both in legislative form and in the reasons urged for its support. In form the law demands the cash

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payment of a certain per cent of the annual clear income of each citizen. The payment is supposed to rest where the charge is placed, and in the vast number of instances this will be the case. Assuming the ability to pay to be the just measure of payment, income is accepted as the surest test of ability. In years when business is prosperous the payment would be large; in years of depression the payment would be small. From the point of view of the citizen nothing could be more considerate and no tax more easily borne. The demand of the state would increase or decrease as the fund from which the payment is made increases or decreases. This is not presented as an argument either for or against an income tax, but rather, to show the simplicity of the idea underlying it. Speaking logically (not historically), the income tax is the original tax, and all other taxes are complementary to or a substitute for this tax in those points in which it is difficult of application; for this assumption at least permits the student to appreciate most easily and naturally the relation existing between the various sorts of taxes.

Income taxation, it must be conceded, is no new or untried form of raising revenue for public purposes. It is now in successful operation in, and has been permanently adopted as a part of the fiscal system of, nearly all of the European countries, several of the states and the Federal Government of the American Union. Wisconsin was one of the first states to adopt an income tax; and, in 1912, the Tax Commission of Minnesota, desiring to recommend the adoption of an income tax for that state, made a complete and thorough investigation of the Wisconsin system. We quote from their 1912 report, at page 159:

Results of the First Year

In point of revenue the income tax law in Wisconsin has in its first year more than met the expectations of its advocates. The income tax assessed this year will exceed $3,000,000. This is quite a remarkable showing for the first year, especially when compared with results obtained in other states that have experimented with similar laws. It even exceeds the amount collected under the first federal income tax law in 1863 by more than $550,000, although that law applied to the entire country.

Of the total tax, corporations will contribute about $2,200,000, or nearly 66⅔ per cent of the total, and individuals and firms about $1,100,000, or 33⅓ per cent of the total tax. It is estimated that the average rate on corporations will be between 5 and 6 per cent, while the rate on individuals and firms will be slightly in excess of 2 per cent.

The preceding figures represent the total income tax assessed from which, of course, a very considerable deduction will be made for taxes paid on personal property. No accurate data is yet available as to how much this offset will be, but from investigations already made it is estimated that the net tax on individuals will be about 80 per cent, and on corporations about 50 per cent of the total income tax assessed. On this basis the income tax will yield net above the personalty offset about $1,980,000, of which amount the state will receive $198,000, the counties $396,000, and the towns, cities and villages $1,387,000. These amounts represent clear gains in public revenues resulting from the income tax law.

The advocates of the income tax have always contended that eventually such a tax would enable the state to exempt personal property from taxation, except public utilities and banks, without impairing the public revenues. This could almost be done the first year. The entire tax levied on personal property this year is estimated to yield about

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$4,100,000, an amount only about $800,000 in excess of the income tax. It is not improbable that within the next two or three years the personal property tax with the exceptions above indicated, could be entirely abolished without any diminution in the public revenues.

Distribution of the Tax Burden Under the Income Tax

A study of the amount of income tax assessed against individuals in urban and rural districts shows, as would be expected, that the income tax per person assessed is much larger in cities than in the rural districts. There were 45,638 persons, exclusive of corporations, assessed for income in the state, the average tax being $24.33. Dividing the seventy-one counties of the state into two groups, the first embracing seventeen counties containing all of the cities of the first, second and third classes, and the second the remaining fifty-four counties containing a large percentage of rural population, we find that in the former the average tax is $27.73 per taxpayer, while in the second class the average is $15.20 per taxpayer. Basing the tax on population, the difference between the two groups is still greater, the former paying 76¼c. and the latter 16¾c. per capita.

An analysis of the income tax assessment in five selected counties—Dodge, Chippewa, Rusk, Marathon and Dane—discloses some interesting data on the distribution of the tax burden under an income tax. The total amount assessed in these five counties amounts to $250,571. The offset for personal property taxes, based on 1911, will amount to $101,242, leaving a net income tax of $149,329. Of this amount corporations will contribute $93,172, or 62.4 per cent, and firms and individuals $56,157, or 37.6 per cent. Dividing the 37.6 per cent paid by others than corporations, we find that the increase over personal property taxes will be less than 1 per cent for the farmers assessed for income, about 3½ per cent for merchants, 8 per cent for manufacturers, and a little over 11 per cent for the professional classes, as compared with the 62.4 per cent paid by corporations.

A comparison of the average income tax of each individual taxpayer with the average personal property tax paid last year in the different income classes in the same group of counties is equally interesting. The total number of income assessments in this group of counties is five thousand, one hundred sixty. The average income tax in the group is approximately $49 per individual taxpayer. Last year the average personal property tax was $37 per taxpayer, showing an average increase of $12 per person on income over personal property taxes. The greater part of this increase, however, is on incomes of $3,000 and over. In other words, the increase falls on those able to pay—on the rich rather than on the poor. For example, those having no taxable income would pay nothing if personal property taxes were abolished; those having taxable incomes of less than $1,000 would pav $2 less than they are now paying in personal property taxes, while those having taxable incomes under $2,000 would pay approximately the same as they are now paying. The increase on incomes under $3,000 would be about $5; on incomes under $4,000 the increase would be $68, while on incomes of $10,000 and over the increase would exceed $600. These are significant figures and indicate that if income is the correct measure of ability to pay, the Wisconsin income tax law is working admirably in this group of counties.

Cost of Administration

The cost of making the income tax assessment will be less than $90,000 this year. This is a low figure when it is considered that any new system of taxation is generally more costly in administration the first than in subsequent years because of the extra expense incident to the inauguration of new taxing machinery. The net cost, however, will be much less than the above figures would indicate. In addition to assessing incomes the income tax assessors also perform the duties formerly entrusted to the supervisors of assessment, the latter office having been abolished. This in itself is a strong feature of the new law and has resulted in a decided improvement in the assessment of the general property

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of the state. This change effects a saving of about $55,000 in salaries, leaving the net cost of the income tax assessment about $35,000, or a trifle over 1 per cent of the yield.

Centralized Administration the Strong Feature of the Law

Centralized administration is the strong feature of the Wisconsin income tax law and much of its success is undoubtedly due to this important provision. It is also strong in many other features not heretofore included in the income tax laws of other states. They are thus summarized by a member of the Wisconsin state tax commission:

"In the minds of practically everybody connected with the administration of the Wisconsin tax, three more or less novel conclusions have been established beyond reasonable doubt.

"First, the American taxpayer is honest and will tell the truth provided you take the trouble to ask him direct questions and provided the rate of taxation is reasonable and not—as the ordinary property tax rate is on securities—confiscatory. The maximum rate under the Wisconsin income tax is 6 per cent, whereas the old property tax frequently took from 20 to 60 per cent of the net income from credits when by some unhappy chance the assessor happened to find them.

"And the Wisconsin assessors have asked specific and direct questions. These assessors themselves constitute a new phenomena in American financial history. They were selected through the Wisconsin Civil Service Commission after tests based on merit and efficiency alone; they hold office practically during good behavior; they are paid fair though not generous salaries; and they give practically their entire time to the work. Nothing was known of their politics before their appointment by the state tax commission, but enough is known now to say that there are among the assessors republicans, democrats, socialists and prohibitionists. They work under the control and direction of the state tax commission. So long as they do their work fearlessly, impartially and tactfully they will keep their places regardless of politics.

"The second conviction noted above is simply that the idea of collection at source has been greatly exaggerated. A very large majority of the stockholders of the corporations represented in any state live in the state. With respect to these the tax can be collected at the source. Moreover, every corporation doing business in a state can be, and in Wisconsin has been, asked to report all the stockholders and salaried employees living in Wisconsin with the dividends and salaries paid to them, respectively. Furthermore, corporation bonds may be defined as an interest in the business and the tax is collected directly from the corporation, the corporation being authorized to deduct the tax from the interest when it has not covenanted to pay the tax itself. This has been done in Wisconsin. The remaining forms of income will be taken care of by the honesty of the average taxpayer when the rate is reasonable.

"This surprising notion of the honesty of the taxpayer is not mere sentimentalism and not mere buncombe. It is completely borne out by the facts. The impression of practically everybody connected with the administration of the Wisconsin income tax is that more than 90 per cent of the net income theoretically taxable under the Wisconsin law has been voluntarily returned. Border line questions have in many cases been decided in favor of the taxpayer, and there has been considerable uncertainty about difficult, doubtful points, but in the large majority of instances attention has been voluntarily directed to these points, and almost never has any attempt to conceal the facts been encountered when the taxpayer was questioned. The assessors did not predict this; they did not expect it; but they now know it.

"The third novel conclusion is that a state income has, as contrasted with the federal income tax, more natural advantages than disadvantages. It may have where properly administered, and does have in Wisconsin, ten times the local knowledge because it can have ten times the number of assessors by combining the machinery of the general tax system with the machinery of the income tax. In literally hundreds of cases the writer has discovered that reports under the Wisconsin income tax were more carefully made than under the federal corporation excise tax and

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fewer doubtful questions decided in favor of the taxpayer. In Wisconsin taxpayer A is used to check the accuracy of taxpayer B. What is outgo to B is income to A. B is asked to tell with respect to certain important items of outgo the names and addresses of the recipients. There is thus a cross-check of which the Federal Government could probably not avail itself. In any event, the writer feels certain that the assessment rolls of Wisconsin now record a higher percentage of actual taxable income than the Federal Government has on that part of its records which cover the same taxpayers.

". . . The great majority of the people of Wisconsin are more than satisfied with the income tax and if it is repealed it will be due to general political complications, not to dissatisfaction with the operation of the law itself. Moreover, the state income tax has come to stay. Wisconsin itself is not naturally particularly good soil for the income tax, which thrives best in urban and thickly populated communities. If Wisconsin can do so well with the tax, urban states like Massachusetts, Connecticut, Rhode Island and the like could do infinitely better. Let one such commonwealth try the state income tax and its possibilities will cease to be a matter of dispute. It will spread like wildfire."

CONCLUSIONS

That the Wisconsin income tax law has been a remarkable success for the first year is now generally admitted. Not only has it resulted in a large increase in revenue, but it has unquestionably distributed the tax burdens more equitably among those able to bear them than ever before in the history of the state. Under its provisions a considerable amount of the public revenue will come from people of large incomes, many of whom have heretofore contributed but little to the expense of government. If income furnishes the proper measure of the taxable capacity of people, the Wisconsin income tax law is a long step in the direction of greater justice in taxation.

Nevertheless, while the success of Wisconsin in its first year's experience with a state income tax has far exceeded the expectations of its advocates, yet it could scarcely be claimed that one year is sufficient time in which to fully test out an old principle of taxation clothed in new administrative machinery. A more extended experience will probably suggest a number of desirable changes in the law to make it fit the industrial and social conditions of the state. Its ultimate success, however, is full of promise. Minnesota, in common with other states, will watch with interest the experience of Wisconsin with its new law, and if successful as we believe it will be, this state may eventually follow the example of its sister state by incorporating an income tax law into its revenue system.

The ultimate results of the income tax in Wisconsin have even exceeded the expectations of its advocates in that state and in Minnesota. In 1920 the State of Wisconsin levied approximately $12,000,000 on incomes, and as the personal property off-set amounted to $5,000,000, the net yield of the income tax for that year amounted to $7,000,000. Ten per cent of this amount was retained by the state and the remainder was allocated to the various districts and local subdivisions.

The Manitoba Commission also advances the opinion that:

In theory we believe this principle of taxation is both attractive and necessary. Any system which exacts payment from those that have the means to pay, relieves those that have not, taxes moderate incomes lightly and large incomes more heavily, makes strong appeal for popular favor, and has much to commend it on the economic side. The income tax principle was applied in Florence in the fifteenth century, and in

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France throughout the eighteenth century. In 1779 it was adopted in England, and though discontinued after the close of the war with Napoleon, it was reintroduced by Sir Robert Peel in 1842. England's example has since been followed by practically all the leading nations of the world. It has also been introduced, as previously observed, in many of the American states, and is also in use in the Canadian provinces of Ontario, British Columbia and Prince Edward Island in certain degrees. It will, therefore, be appreciated that our recommendation for its introduction in Manitoba is not based upon a hypothetical foundation.

Honorable Thomas E. Lyons, in address delivered at the Blackstone Institute, in 1916, said, with respect to the operation of the income tax in Wisconsin, that:

The conventional criticism of the income tax is that it is all right in theory but will not work in practice. If this criticism is well founded it constitutes a fatal objection to this form of taxation. In last analysis a fiscal system must be tested by results, and the important question is how the income tax actually operates in practice. The first and most obvious test of a tax system is its power to produce revenue, and the income tax has completely met this test. This is shown by the fact that the yield of the tax in England and Germany before the present war broke out exceeded $200,000,000 annually in each country. The assessment of 1915 income by the Internal Revenue Department at the relatively low rates prescribed by the act of 1913 resulted in a tax of $124,937,252. In Wisconsin the assessment of incomes for the same year produced a tax of $5,344,303. It is estimated that the average annual income of the people of the United States from all sources is over $30,000,000,000 and that 20 per cent of the heads of families receive 47 per cent of this amount and that 2 per cent of them receive more than 20 per cent of it.—King's Wealth and Income, 132. The Internal Revenue Department reports that one hundred twenty persons in the United States received an income of more than $1,000,000 each in 1915 and that the aggregate taxable income assessed for that year was $8,703,068,389. These figures amply demonstrate the possibilities of this form of taxation as a revenue producer.

A Tax on Wealth

A study of the returns under income tax laws conclusively shows that the income tax is a tax on the rich and well-to-do. The liberal exemptions allowed by the Federal law exclude the great bulk of the population from its operation. According to the report of the Internal Revenue Department, only about ½ of 1 per cent of the population is subject to the tax. In Wisconsin, with lower exemptions, less than 3 per cent of the population come within the law. Further analysis of the returns indicates that the limited number receiving large incomes pay most of the tax. Thus three hundred twenty-nine out of a total of 366,443 persons assessed under the Federal income tax law in 1916 paid about one-fifth of the total tax. In Wisconsin sixty-two persons receiving an income of over $50,000 each paid 23 per cent of the tax assessed against individuals, and fourteen out of an aggregate of 62,272 taxpayers representing only 1/200 of 1 per cent of the total number paid over 12 per cent of the tax. In the county of Dane, in which the capital is located, three individuals receiving an income of over $25,000 each paid one and one-half times as much tax as the two thousand, two hundred fifty persons having less than $1,000 income apiece.

Where the earnings of corporations are assessed at the full progressive rate as in Wisconsin, they pay the bulk of the tax. The aggregate tax assessed under the Wisconsin law on 1915 income was $5,344,393, and of this amount corporations were assessed for $3,473,180, or 70 per cent of the total. While corporations paid only the normal rate of 1 per cent prescribed by the Federal law of 1913, their aggregate tax, according to the last assessment, was $56,993,658, or about 45 per cent of the total. If the income of these corporations had been subject to the full tax prescribed for individuals under the same act, the yield would probably

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have been five times that amount. The total number of corporations assessed in Dane County for income of 1915 was three hundred thirty-four, and the total tax thereon $133,939, and one corporation engaged in the production of war material paid $67,642, or more than one-half of this total. As enterprises of this character are generally located in cities, it follows as a corollary that the yield of the income tax is primarily derived from urban centers. The liberal exemptions and relatively small income received by agricultural classes practically exempt them from the operation of the law.

Objections to Income Tax

Complaint is often heard that the income tax is a class tax for the reason that so small a part of the population pays such a large proportion of the yield. But every other tax is subject to this criticism, in greater or less degree. The general property tax reaches only the comparatively small part of the population owning property. Privilege and occupation taxes apply only to those exercising the privilege or following the particular occupation subject to the law. The inheritance tax is confined to those who die leaving a substantial amount of property, and even the poll tax is limited to male adults of certain ages. The test of a tax is not whether it reaches the entire population but whether it applies equally to all persons similarly situated. The income tax satisfies this requirement by applying the same rate and imposing the same burden upon all persons who have the same income. The fact that those who have large incomes pay a larger tax is readily justified by their greater ability to pay and the greater sacrifice involved in the payment of a tax by those who have small incomes. Moreover, in the face of increasing public expenditure and growing demand for public revenue, it is not apparent why those engaged in business yielding returns should not make corresponding contributions to the support of government. The income tax is the only one that reaches all classes of excess earnings.

Objection is often made that an income tax law is inquisitorial, but so are all tax laws when properly administered. Under the property tax law the assessor may examine the taxpayer and call his neighbors to testify as to the amount and value of his property. He may even disregard the taxpayer's sworn statement and increase the assessment as justice may require. According to a recent bulletin of the Federal Census Bureau, the cost of government throughout the United States has practically doubled within the last ten years, and there is little to indicate that the maximum has yet been reached. In the face of these mounting public burdens, taxes will be imposed in one form or another, and the public will insist upon the necessary information to measure the amount chargeable to each citizen. Concealment and evasion will not permanently prevail. The choice lies between a flexible and adjustable system and a rigid and mechanical one, with a long train of injustice in its wake.

Congressman Hull, in presenting the 1913 income tax bill to Congress, stated that:

During recent years there has been a general agitation and demand in almost every state in the Union and in almost every country in the world for intelligent, fair and practical reforms and readjustments of their tax systems to the end that every citizen may be required to contribute to the wants of the government in proportion to the revenue he enjoys under its protection. To this end the doctrine of equality of sacrifice or ability to pay is being universally invoked.

We believe that any income tax adopted by Louisiana should carry liberal exemptions. A citizen should be first permitted to earn enough to support his family before being called upon to

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contribute to the government under an income tax. In Wisconsin the exemption is $800 for single persons and $1,200 for married persons. In Massachusetts, which has a classified income tax, there is an exemption of $300 on Classes A and B, representing income from interest or dividends from certain intangibles and annuities, providing the total income from all sources does not exceed $600; on Class C, covering profits over losses arising from the sale of intangibles, no exemption is allowed; but on Class D there is an exemption of $2,000 (with possible further exemption not exceeding $1,000) on income derived from salaries, business and professional income. The New York income tax exemptions are the same as those allowed by the Federal Government, viz., $1,000 for a single person and $2,000 for a married person.

This theory of exemption has been incorporated in every system of income taxation, and is supported by Professor Adams, in the following language:

> The duty of the financier is not limited to the getting of revenue, but he is obliged to get revenue in such a manner that the source from which it is derived shall never be exhausted. He must hold in mind the needs of the future as well as of the present, and is therefore debarred from employing the taxing power in such a manner as to dry up the springs of present revenue or to hinder the development of an enlarged supply.
>
> One of the most common facts in connection with modern systems of taxation is the exemption of incomes and property below a certain amount, and many financiers justify this exemption on social considerations. It is not right, they say, to call upon a citizen to contribute to the budget of the state until the necessary domestic budget has been provided for. Without admitting any man's right to live in the modern state without contributing to its support, a modified application of this principle may be defended on purely fiscal grounds. The surest source of public wealth is a lively hope and a healthy expectation on the part of the great body of citizens, and in so far as exemption of low incomes and small salaries from taxation induces to the conditions from which this hope springs, such exemptions will tend to the expansion of a nation's wealth. If this be true the exemption of small incomes from direct taxation, as also of the property of those who relatively are poorly able to pay for the support of the state must ultimately result in the development of a source of wealth from which the state may expect an increased revenue.

Senator Ogden L. Mills, a prominent lawyer of New York, and President of the New York Tax Association in an address delivered by him to that organization, observed that:

> The income tax is the fairest kind of tax, because it taxes every man in accordance with his ability to pay. Taxes are paid out of income, and the income which a man enjoys is the fairest test that can be devised of his ability to contribute his share to the cost of government. A man who has made an unfortunate investment, or who owns a new business which has produced and made no return, is not in as good a position

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to pay taxes as the lawyer or professional man earning a large income, and yet the former, under a property tax, is obliged to contribute, while the latter escapes entirely. The income tax is the only tax that will reach the professional and salaried classes who enjoy big incomes which are today tax exempt.

It is stated in the report of the Special Commission of Nebraska that:

The merits of the income tax are unquestioned. Among peoples well advanced industrially, it is an essential aid in bringing about an equitable apportionment of the tax burden. (1) As a test of ability, it is a fairer basis than the value of property upon which the property tax rests, for the reasons pointed out elsewhere, that all kinds of property are not equally productive and not equally indicative of the ability of the citizen to pay taxes. (2) In the second place, it is needed to reach that considerable class of persons in each community who enjoy an income out of all proportion to the property owned. And in the third place, it is desirable as a substitute for the troublesome personal property tax.

Professor Charles J. Bullock, in reply to a direct request by the Chairman of the Manitoba Commission, expressed the following opinion with respect to the personal income tax:

A personal income tax ought to be adopted in your Province whenever public opinion is ripe for it. It is the best tax which you can levy as a supplement to your tax on real estate, and I think it probable that in time most of the Canadian provinces and American states will come to adopt it. Whether the time has yet come in Manitoba, I am not able to judge. The tax ought not to be adopted unless the people are willing to favor adequate machinery for enforcing the tax, and are ready to accept it as a reasonable method in determining their liability for the support of government. The operation of the income tax depends wholly upon the conditions in which it is levied. With poor administration, excessive rates, and a hostile public opinion, an income tax becomes a mere tax on honesty, while under opposite conditions it can be enforced with substantial certainty and justice, and as successfully as most other laws. Some evasion there will be, necessarily, but it is possible for an income tax to be so drafted and administered as to command public favor and reduce the amount of evasion to a reasonable minimum. Wisconsin has already shown that with proper methods of administration, a reasonable income tax can be collected with substantial certainty and completeness; and against Wisconsin's evidence, the experiences elsewhere under very opposite conditions count for little or nothing.

And Professor Adams of Yale University said, in a communication to the same Commission, that:

The literature on the subject of the personal Income Tax is now so vast, American opinion now so nearly unanimous and the results of American experience so nearly conclusive—at least for the United States—that extended discussion seems unnecessary. The state of provincial income tax is now a demonstrated success.

The Manitoba Commission recommended the adoption of a progressive income tax, and approved an exemption of $1,000 for unmarried persons and $1,500 for married persons, with a further exemption for each child or dependent of $200. The Commission further "recommended that the administration of any

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income tax law that may be enacted be wholly administered by the Tax Commission, save that the tax collections be made by the local authorities."

The members of our Commission think that a differentiation should be made between earned and unearned incomes. This principle has long been recognized in Great Britain, and the Royal Commission on the Income Tax, in an exhaustive report submitted to Parliament in 1920, stated that:

Differentiation is the term used to express the discrimination that is made for Income Tax purposes between incomes that are earned by personal exertion and incomes that are not so earned. We are satisfied that some such discrimination is desirable and just. Although recognition of the principle was a long time in coming the demand for it is practically as old as the tax itself. We have not had much evidence advanced against the principle of differentiation, and we are convinced that to do away with the advantage which since 1907 has been granted (within certain limits) to incomes earned by personal exertion would be a distinctly retrograde step, and would ignore the deeply-rooted conviction which undoubtedly exists in the public mind that there is a real difference in taxable ability between the two classes of income in question.

The application of graduated rates is so well-nigh universal that it is hardly a debatable question in the majority of countries and states that have adopted the income tax. The Royal Commission thus tersely stated its position on the question of "graduation":

We do not feel called upon to defend with arguments the principle of graduation of the Income Tax. Direct graduation of the tax was bitterly opposed for many years, but it is now almost universally admitted to be as sound in principle as it is imperatively necessary in practice. We are therefore concerned more with the practical than with the theoretical aspect of the subject—not so much with the principle as the means by which that principle can be translated into practice.

* * *

So long therefore as it is necessary to depend on the Income Tax for a great part of the revenue, and so long as there is an exempt margin of income, an abatement appears to be essential. That being so, we have the choice (a) of giving to all incomes the abatement necessary in the case of smaller ones, and of effecting further graduation by other means; or (b) of complicating the system by diminishing the abatements at certain limits of income and finally extinguishing them as is done at present.

As stated elsewhere in this report, in recommending the adoption of an income tax, we contemplate the exemption from taxation of certain kinds of tangible and intangible personal property, among which may be mentioned: Credits of all kinds, such as open accounts, promissory notes, franchises, the capital stock of banks; household property, diamonds and jewelry, business furniture and fixtures, and agricultural tools and implements.

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Experience has taught us that it is physically impossible to ever place all of this class of property on the assessment roll, regardless of how stringent or efficient the administration may be; without, of course, hiring a horde of tax officials, the so-called "ferret" system of some states, in which case the cost of assessing and collecting the tax is more than the amount realized in taxes.

INCOME TAXES [1]

The recent adoption of effective income taxation into this country affords an interesting illustration of the triumph of a sound economic idea over formidable obstacles. The legal barriers which had to be surmounted have already been mentioned, but there were other difficulties to overcome equally formidable. Income taxes had been on the statute books of American commonwealths since the seventeenth century, and had been consistently and continuously ineffective. The tax was generally believed to be too intricate and too inquisitorial for the American people, schooled by the crudities of the general property tax to evasion of and contempt for tax law. Expert opinion had come to hold that the income tax, though "sound in theory," made too many demands upon both the taxpayer and the tax administrator to thrive in American soil. Yet in the last five years income taxes of the European type have been put into successful operation by both state and Federal governments and give every promise of assuming, in the future, a place of major importance in the American fiscal system.

The mistake of the experts arose rather from an underestimate of the strength of the income tax than from an underestimate of its difficulties. The alleged weaknesses of the income tax were not imaginary. Experience has shown that it is a complex and difficult tax to formulate and administer. Just what items of gross income should be included and what losses, expenses, and other deductions allowed, are questions which bristle with difficulties. Some forms of income are not expressed in money and usually escape taxation; on the other hand, it is almost impossible to avoid double taxation, particularly in dealing with interest and dividends. The tax has also the difficulty of being a class tax: the federal income tax touches

[1] Ely, Richard T. et al. Outlines of Economics. p. 720-3.

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directly less than 1 per cent and the Wisconsin income tax less than 3 per cent of the respective populations affected. The tax is predominantly a city tax and farmers generally escape; owing to the facts that they usually do not keep books and that much of their income does not find expression in terms of money; although it must be admitted that relatively few farmers receive incomes above the exemption limit. Finally, the mixture of "withholding at source" and direct collection, in the Federal tax, imposes large and unjust expenses of collection upon private taxpayers, complicates the administration of the tax, and in some cases leaves the taxpayer to become the sole judge of the taxibility of certain items of income and of the deductibility of certain losses and expenses.[1]

Despite all these difficulties, however, the income tax has succeeded. It is reasonably productive and will become more productive as time passes: the federal income tax in 1915 yielded a revenue of over $80,000,000, and in 1916 it produced over $100,000,000. It is elastic, and can be made more productive by simple increase of rates. Above all else, it realizes with reasonable success "taxation according to ability." Property taxes pay little attention to the ability of the owner of the property. They fall upon property as such whether it is free or encumbered by debt; they must be paid by the unsuccessful as well as the successful; in lean years as well as fat years. The income tax, on the other hand, does not affect the very poor at all; it spares the unsuccessful business, the new business in its developmental stage, and the old established enterprise in times of business depression. Its appeal is thus not only to the humanitarian sentiment of the age, but to the common sense of the business man. Except when collected at source (when it acts in small part like an excise) it is subject to little or no shifting. And, unlike the property tax, it grows stronger with age and continued use. The countries which have tried the income tax keep it; and in the last quarter of the century practically every large country in the world which did not already have the income tax has introduced it.

The mistake of the critics in condeming the income tax for American use was due very largely to a misinterpretation of the failure of the personal property tax. That tax is largely evaded.

[1] A criticism of the federal income tax by a disinterested and competent committee of the National Tax Association will be found in the Proceedings of that association, v. ix.

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The critics inferred from this that American taxpayers are liars and would similarly evade an income tax. Experience with the income tax has shown, however, that the average American taxpayer is honest and will make an honest declaration if the tax be equitable and tax officials at the same time firm, competent, and considerate. The personal property tax in this country has failed, not because the taxpayer is dishonest, but because the tax is at times barbarously severe in burden, strikingly unequal in operation, and administered by officials who are frequently incompetent and out of sympathy with the tax itself. Moreover, the income tax is no more complicated than any other direct tax involving valuation and assessment. It appears to be more complicated than the property tax merely because in drafting income tax laws it is customary to anticipate all problems of detail and define the proper answer in the statute itself; whereas, in property tax laws almost all the difficult questions are avoided by laying the tax on the "fair cash" or "market value" and leaving the meaning of this term to be decided by the judgment of the assessor. In the average case, it is easier to determine a man's income with reasonable accuracy than it is to determine with the same degree of accuracy what his property is worth.

Absentee ownership increases with industrial development, and much income is now derived from particular jurisdictions by persons who reside elsewhere. This leads, in practice, to double taxation, as both the jurisdiction in which the recipient lives and that in which the income originates are likely to impose the tax. Such double taxation is reduced as the jurisdiction is enlarged to which the income tax applies; and for this reason many authorities advocate the exclusive employment of the income tax by the Federal Government. If the income tax cannot be employed by both state and Federal governments, this conclusion is warranted. But we see no reason why the states should renounce the income tax and use substitutes which are manifestly inferior, merely because the Federal government is employing the same tax. Nearly all taxes must be paid out of income. The specific tax employed is merely a device for distributing the tax. Why, then, should the state employ a poor method of distribution, such as that embodied in the personal property tax, when it might employ a tax which with substantial accuracy lays the burden in accordance with ability to pay? As a matter of fact, the federal income tax is likely to encourage

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the adoption of state income taxes, because the federal tax familiarizes the people with income tax products, and with simple modifications a report prepared for the federal government can be used for the state government. We should have, not hostility between state and federal administrations, but joint and cooperative use of many forms of taxation.

BRIEF EXCERPTS

The operation of the general property tax has come to be recognized as a grotesque and lamentable failure. *William L. Garrison, Jr. Survey. 35 : 475. Ja. 22, '16.*

The State or Provincial income tax is now a demonstrated success. *Thomas S. Adams. Report of the Louisiana Assessment and Taxation Commission to the Constitutional Convention. 1921. p. 45.*

We believe that the time has come to enter upon a more scientific method of raising revenues for state and locality and for the relief of real estate. In this connection, the Commission recommends the enactment of a general personal income tax at a low rate, which will be a tax on income after it is received by the taxpayer based upon the taxable ability of the recipient of such income. *Annual Report of the New York State Tax Commission for 1918. p. 68-9.*

The income tax is fiscally adequate. Under proper conditions it will produce probably more revenue for the state as a whole than it is possible to obtain from intangibles under the general property tax. We may therefore confidently expect to add to the state and local revenues by introducing such a tax. The necessary condition is the adoption of such a system of property taxation as will permit the exemption of intangibles and the use of a properly graduated tax on incomes. *Harley L. Lutz. Report of the Special Joint Taxation Committee of the 83d Ohio General Assembly. 1919. p. 124.*

Another common objection is that the existence of an income tax in a given state operates as a handicap to business and an additional burden on its citizens in competition with rivals in states where no such tax exists. But this objection does not

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stand the test of analysis on either theoretical or practical grounds. The people of every community must raise whatever revenue is required to maintain their own government. Whether they use one or many methods of taxation for that purpose is wholly immaterial. *Report of the Wisconsin Tax Commission. 1920. p. 52.*

The merits of the income tax are unquestioned. Among peoples well advanced industrially it is an essential aid in bringing about an equitable apportionment of the tax burden. (1) As a test of ability it is a fairer basis than the value of property upon which the property tax rests for the reasons pointed out elsewhere that all kinds of property are not equally productive and not equally indicative of the ability of the citizen to pay taxes. (2) In the second place it is needed to reach that considerable class of persons in each community who enjoy an income out of all proportion to the property owned. And in the third place it is desirable as a substitute for the troublesome personal property tax. *Report of the Nebraska Special Commission on Revenue and Taxation. 1921. p. 171.*

Recognizing, as we do, that an income tax is perhaps the fairest and most equitable method of raising revenue, particularly from those classes of property which are the most difficult to assess, we are pleased to note that Congress has enacted a law which gives those states having an income tax law, upon the request of the Governor of the state, access to the data upon which the federal income tax is now assessed, so far as it affects corporations, and we hope that a similar provision will soon be made in that affecting the income of individuals. The only reasonable objections to taxation by this method being the difficulty and expense attending its administration, and both of these having been almost entirely eliminated by the granting of the privilege mentioned above, we recommend that Georgia get in line by enacting, as soon as the constitutional amendment herein provided for will permit, a law providing for taxation on an income basis, and at a very low rate. *Report of the Special Tax Commission for Georgia. 1919. p. 43.*

The conclusions of the Committee with respect to the income tax law, as a possible method of relief from the evils of the general property tax are:

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(1) That the basic principle of the personal income tax is sound and that the income tax is an essential pârt of any well-balanced system of state taxation; (2) that its place in the system of taxation for South Carolina is as a supplement to a properly classified property tax; (3) that it should be used as one of the principal sources of state revenues, so as to leave the taxation of property largely to counties and the other local taxing districts; (4) that the constitutional provisions requiring taxation of all property at a uniform rate affect the application of a general income tax law to an extent that makes it inexpedient to enact and to attempt to administer the income tax as a part of the state's system of taxation at this time. *Report of Joint Special Committee on Revenue and Taxation. South Carolina. 1921. p. 97.*

It has been and will be said that while an income tax may be all right for national purposes, it is unsuited to and impracticable for individual states. Modern commerce pays little heed to state boundaries, and most commercial concerns of any magnitude conduct business in more than one state. The difficulty of allocating this income to the state of its origin is a real one, and may be flatly acknowledged. It is not insuperable, however, nor is it confined to income taxation alone. The same problem arises in the administration of inheritance tax laws and in the assessment of interstate railroads and other public utilities under the general property tax. It also arises in the regulation of public service companies where national and state jurisdictions conflict, and in administration of pure food laws and other exercises of the police power. Although difficult the problem has been met in these fields. Recent decisions of the United States Supreme Court on assessments made under state income tax laws go far to remove this objection, and indicate that the principles already established in dealing with interstate problems under the property tax, rate regulation and pure food laws will be applied to the taxation of incomes. *Report of the Wisconsin Tax Commission. 1920. p. 52.*

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NEGATIVE DISCUSSION

TAXATION OF INCOMES [1]

In theory an income tax is an ideal one. Much property is necessarily carried by citizens of a state that is unproductive, and hence yields but little income out of which taxes may be paid; while, on the other hand, if the state only demands a part of the income actually earned, it works no hardship on its citizens. If each man paid taxes according to his income, those who have most would pay most, and those who have least would pay least.

But theory and practice do not always harmonize. It is not difficult to devise an ideal system of taxation theoretically, but, unfortunately, theory often fails in its practical application. While it is true that a majority of students of political economy advocate the income tax as an ideal system of taxation, it is also true that its practical application to the social and industrial condition of the American people has thus far been a failure.

The taxation of incomes as a source of state revenue is not a new theory in state finance. It has been tried in many of the American states, and the system still obtains in several of our commonwealths. Many European countries have been trying to solve the problem of the successful taxation of incomes, and while it is not contended that they have succeeded, yet some notable advances have been made in that direction. As no investigation of this subject would be complete without a study of its history in other countries, a brief review of the income tax in some of the European countries will be included in this chapter.

The Income Tax in the United States

The history of the income tax in the United States covers a period of nearly two hundred seventy-five years. As early as

[1] Second biennial report of the Minnesota Tax Commission. 1910. p. 156-69.

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1634, the colony of Massachusetts Bay provided for a "faculty tax," which was in principle the same as an income tax. Other colonies followed the example of Massachusetts. The earlier history of the tax in the colonies was characterized by indifferent and unsatisfactory methods both as to determining the income of the individual and the collection of the tax. As a consequence, the laws were frequently changed, but with little apparent improvement.

We are not concerned, however, with a study of the income tax in colonial days, and but little interested in its earlier history in some of the states of the Union. The social and industrial conditions of the country have undergone such great changes in the past four or five decades that a system of taxation fairly suited to the conditions existing forty or fifty years ago might be entirely unsuited to present conditions. Conclusions, favorable or otherwise to an income tax, based on the experience of American colonies and states in our earlier history would be of doubtful value at this time because of changed conditions. We shall, therefore, confine our study of the question to the several states that have attempted to impose such a tax in recent years.

Of the forty-six states of the Union, seventeen have made provision for an income tax, either in general or special form, while several of the other states endeavored to enact such a law, but without success. Some thirteen or fourteen tax commissions have treated the subject in their reports with varying conclusions. We are, therefore, fortunately not confined to a study of the theoretical side of the question only, but can refer to the actual experience of several states in their efforts to raise a part of the public revenue by means of an income tax.

The Income Tax in Massachusetts, Virginia, North Carolina and Louisiana

Mr. Delos O. Kinsman, in the Quarterly Journal of Economics for February, 1909, thus summarizes the experience of four states in recent years with the income tax:

There have been three periods of income tax activity in the United States: the first from 1840 to 1850; the second from 1860 to 1870; and the third, or present period of activity, which began about 1895. The keen interest in the subject during recent years is evidenced by the fact that since 1895 sixteen states and three territories have paid attention to the tax either by constitutional amendment, legislative enactment, or in commission reports.

The four states employing the tax at the beginning of this period—Massachusetts, Virginia, North Carolina, and Louisiana—have been little

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affected by the present movement. The law in Massachusetts, as it has stood since 1873, provides that "income from any profession, trade or employment shall not be construed to be personal estate for the purpose of taxation except such portion as exceeds the sum of $2,000 per annum, provided, however, that no income shall be taxed which is derived from any property or estate which is the subject of taxation." This act, which was the result of compromise, has yielded little revenue to the state. Indeed, it has been asserted by the tax commissioner that the "machinery of the Massachusetts tax laws is not adapted to the enforcement of an income tax, and until it is, the income tax can never attain a prominent place in our system." And this statement was made after the appointment of a deputy tax commissioner whose duty it is to visit each city and town in the state for the purpose of obtaining greater uniformity in taxation.

Virginia, likewise, has apparently been uninfluenced by the present activity. While she has the somewhat unique practice of frequently reenacting her revenue laws, she has, for more than a generation, made little change in her income tax. For some time all forms of income—rents, wages, interests, and profits—have been taxed. Besides certain specified deductions a general exemption ranging from $600 to $1,000 has been allowed. The present law, enacted in January, 1908, provides for the taxation of "the aggregate amount of income in excess of $1,000, whether received, or due but not received, within the year next preceding the first of February in each year." The law then proceeds to enumerate in detail the sources of rent, interest, salaries, and profits upon which the rate may be levied. It further declares that in addition to the exemption of $1,000 any person may also deduct all losses sustained during the year. The administration of the law rests with the local authorities, the income being assessed by the local assessor and the tax gathered by the local tax collector.

The revenue derived from the tax has been slowly increasing in amount. In 1900 it amounted to $46,023, in 1901 to $58,254, in 1902 to $62,221, in 1904 to $71,225, and in 1906 to $94,367. While this gradual increase in the receipts from the tax is encouraging, and the total amount is considerable when compared with that received in other states from the same source, the amount is still unimportant when compared with the total tax of the state.

The state of North Carolina has had a continuous experience with the tax since 1849. Although the law was always simple in form, it reached wages, interest, and profits, and, during a portion of the time, rent. In 1893 the present movement was initiated by the enactment of a new law, containing more specific provisions and introducing a progressive rate. This progressive rate upon income from sources other than taxable property was doubled in 1895, and, as thus changed, continued in force until 1901. In the latter year the law abolished the progressive rate and substituted a proportional rate of 10 per cent upon all incomes in excess of $1,000 except such as were derived from property already taxed. In reply to a series of written questions the taxpayer was required to list, in itemized form, his gross income from all sources except property taxed. The assessor was made subject to a penalty of $5 for each question unanswered, the county commissioners being empowered to collect the fine. Or any individual might bring suit against the assessor and receive one-half the amount collected for his pains. No local unit—city, township, or county—was permitted to levy the tax while the state law was in operation.

The law of 1905 materially changed the law of 1901. The taxpayer was required simply to declare under oath the amount of his gross income in excess of $1,000 from "salaries, fees, trade, profession, and property not taxed." It was made unlawful to publish the income tax list or any part of it, the penalty for such offense being not more than $50 or thirty days' imprisonment. But the assessor might report to the corporation commissioner those listed for the income and those he thought should be listed, and the corporation commissioner was permitted to take such steps as he deemed necessary to secure the assessment and collection of

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such taxes. The law of 1905 was reenacted in 1907 and is in force at the present time.

The state of North Carolina shows an increase of revenue from her income tax during the present period. The law of 1895 yielded in the following year $3,460, while the total state tax was $604,542. In this year, 1896, of the ninety-six counties, thirty-nine returned the tax. Three years later, in 1899, the income tax revenue had slowly advanced to $4,399, while the state tax had increased to $723,307, and fifty-eight of the ninety-six counties now returned incomes.

The appointment of a state tax commission about 1900 was in harmony with the new movement. By issuing a pamphlet of instructions to the assessors, explaining the law, and by carefully supervising the assessments, this commission added, in round numbers, $41,000,000 to the assessment rolls in 1901. It increased the revenue from the income tax from $5,014 in 1900 to $19,030 in 1901. In that year eighty-one of the ninety-seven counties reported the tax. The receipts from it steadily advanced after 1901, until in 1907 when they amounted to $35,958. The total state tax during the same period increased about $100,000.

The tax commission in its report of 1902 said, in regard to the income tax, "there may be some difficulty in working out at first satisfactory details for the assessment and collection of the tax, but it can be done." Although their report of 1904 contains a number of recommendations for the improvement of the revenue laws, no suggestions are found regarding the income tax. Indeed, the state auditor says of the present law, "This is about the best law, I think, we can have in the state and keep within the bounds of constitutional limitations." He further says, "The law of course is in its infancy, and will work better as the years go by, and the increase will be correspondingly greater, I think, in the years to come." The present clerk of the corporation commission says: "The law is proving satisfactory as far it goes. A great many are of the opinion that it should reach incomes from all sources; however, this is a question in which there is a difference of opinion."

Louisiana is the one state that has discontinued the taxation of incomes during the present period of activity. She first levied a tax upon incomes in 1865. Though it continued until about 1900, the law was never generally enforced. The receipts of the tax slowly advanced from $2,476 in 1868 to nearly $25,000 in 1880, but soon began to decline. In 1899, when but two of the fifty-nine counties in the state reported incomes at all, the total receipts amounted to only $104. The report since 1900 makes no mention of the tax whatever.

The Income Tax in South Carolina and Oklahoma

South Carolina experimented with the income tax from 1701 to 1868, when it was discontinued. It was revived again in 1897, and is still in force. The law provides that there shall be levied upon "the gains, gross profits, and income" annually received by any citizen of the state from any source, "a tax of 1 per cent on the amount so derived over and above $2,500 and up to $5,000; 1⅓ per cent on $5,000 and over up to $7,500; 2 per cent on $7,500 and over up to $15,000, and 3 per cent on $15,000 and over." In addition to the general exemption of $2,500, the law exempts interest on United States bonds and state bonds, and also permits the deduction of necessary expenses actually incurred in carrying on the business, occupation or profession.

It is made unlawful for any officer to disclose or allow to be

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made known in any way the amount or source of income, profit or expenditure returned by any person. The amount of the tax to be raised is apportioned by the legislature among the counties of the state, and is levied and collected in the same manner as other taxes.

So far, the income tax in South Carolina has not given general satisfaction, and several attempts have been made to repeal it, but without success. In the first year of its operation, 1898, the tax amounted to $6,890, but four years later, in 1902, it yielded less than $300. In the following three years the receipts from the income tax gradually increased, the amount collected in 1903 being $1,476; in 1904, $1,281; and in 1905, $2,130. It reached the maximum in 1906, the amount collected in that year being $12,201. The receipts for 1907 were $10,687, and for 1908 $8,554. The total receipts from this source for eleven years, 1898 to 1908 inclusive, amounted to only $49,929.

In his report for the fiscal year 1908, the controller-general of South Carolina says:

> The law has never been generally enforced. A determined effort was made by this office through instructions to county auditors in 1906,—that being the re-assessment year for real estate—to exert great diligence in enforcing it, but the results have been far from satisfactory. As stated in my report for 1907, it is evident that only a small part of conscientious people are paying this tax, and others who are liable, and in all probability better able to pay, are escaping and evading its payment. Were the law strictly and generally enforced in the state, it would, in my opinion, secure a revenue of at least $50,000 from this source. Unless some means are devised to secure its general enforcement, it had best be repealed.

The new state of Oklahoma provided for an income tax by legislative enactment in 1908. The law taxes "gross income from salaries, fees, trade, profession, and property upon which gross receipt or excise tax has not heen paid, in excess of $3,500." The rate is ½ of 1 per cent on amounts in excess of $3,500 and less than $5,000; ¾ of 1 per cent between $5,000 and $10,000; 1.2 per cent between $10,000 and $20,000; 1½ per cent between $20,000 and $50,000; 2 per cent between $50,000 and $100,000, and 3⅓ per cent on amounts in excess of $100,000.

It is made unlawful to print any part of the income tax returns unless the tax upon the income becomes delinquent. An attempt is made to secure a better administration of the law by requiring the assessor to send to the state auditor not only the names of those who declare that they have incomes in excess of

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$3,500, but also those who, in his opinion, have incomes in excess of that amount but have failed to make a return, as well as those who, in his opinion, have returned an amount less than their actual income. The state auditor is authorized to take such steps as he may deem necessary to compel any person whose income is questioned to make a correct return. The amount of the tax due upon the income is certified to the county clerk of the county in which the income receiver resides, and collection is made by the county treasurer in the same manner as other taxes are collected.

Proportion of Income Taxpayers to Population

It is interesting to note the proportions of income taxpayers to population in these countries having an income tax. In seventeen states in Europe and Australia the average is about 10 per cent. In Saxony one out of four, in Prussia one out of six, and in England about one out of thirty-seven of the population pays an income tax. The difference in percentage of income taxpayers to population is due largely to the difference in exemptions.

In Prussia, for instance, where the exemption is $214, nearly 90 per cent of the income taxpayers were assessed in 1909 on incomes of less than $715, and only about 3 per cent on incomes in excess of $1,550. Had the exemption been $1,000, only about one in each one hundred fifty of population would have been assessed on incomes. In Austria 85 per cent of income taxpayers are assessed on incomes of less than $815, while about 3 per cent have incomes in excess of $2,500. During the four years of the Civil War income tax in this country, 1867-1870, only about one out of each one hundred fifty of population paid an income tax.

Income Taxation More Successful in Europe than United States

A study of the income tax in European countries leads to the conclusion that both in operation and revenue it has been much more successful than in the United States. This is due, in part at least, to the difference in the industrial, commercial and political conditions of the people of Europe as compared with the United States, and partly to the fact that the principle of taxation at the source of the income rather than that of self-assess-

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ment has been followed in those countries of Europe that have had the most successful experience with the income tax.

The Theory of an Income Tax

The basic theory upon which all proposals for an income tax are made is that individuals should contribute to the cost of government in proportion to their ability, and that income is the most just measure of that ability. That the income tax is an admirable one in theory is generally conceded. Indeed, throughout its history in the states it has never been seriously attacked from a theoretical point of view. Failure has generally been attributed to the inapplicability of the principle rather than to the principle itself. Nevertheless, sentiment in favor of an income tax is rapidly growing. It is felt that we have reached a point in our industrial development that demands some system of taxation that will distribute the burdens of government more equitably than the general property tax is now doing. Every state has a large class of wealthy citizens who, in proportion to their wealth and to the benefits of government received by them, contribute but little to the public burden.

If swollen fortunes could be reached by an income tax, accumulated wealth would be made to bear a much larger share of the burden of taxation than it is now doing, thus relieving the less wealthy and wage-earning classes from a part of the unequal share they are now bearing.

Self-Assessment Not a Success

But however desirable an income tax may be in theory, an investigation of its history in those states that have experimented with it in practice demonstrates that the system followed in this country, that of self-assessment, has not only failed to equalize the burdens of taxation, but has been equally unsuccessful in producing any satisfactory amount of state revenue. While some of the advocates of the tax claim that its failure is due to the indifference and carelessness of public officials in enforcing the law, others contend that the principle is incapable of practical application to the social and industrial conditions of the American people.

Mr. Delos O. Kinsman, who has made a very exhaustive study of income taxation in the United States, and from whom we

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have already quoted in an earlier part of this chapter, thus summarizes his conclusions in his monograph entitled, The Income Tax in the Commonwealths of the United States:

The administration of the law has been much the same in all the states. It has been assessed, as a rule, by the local assessors and collected by the local tax collectors. The laws have required that the tax should be levied by self-assessment, almost invariably under severe penalties for failure to comply . . . The attitude of the state courts toward the income tax has been one of sympathy. In the few cases upon the subject brought before them they have upheld the tax. Had all forces been as active in support of the system as the state courts, the tax would undoubtedly have been a success.

* * *

As a result of our study we conclude that the state income tax has been a failure, due to the failure of administration, which, in turn, may be attributed to four causes—the method of self-assessment, the indifference of state officials, the persistent effort of the taxpayers to evade the tax, and the nature of the income. The tax cannot be successful so long as taxpayers desirous of evading taxation are given the right of self-assessment. Since all attempts to change the method of self-assessment have failed and the nature of industry in the states is at present such as to make impossible the assessment of a general income tax at the source, we are forced. to the conclusion that, even though no constitutional question should arise, failure will continue to accompany the tax until our industrial system takes on such form as to make possible the use of some method other than self-assessment.

Investigation of Income Tax by Tax Commissions

The subject of a state income tax has been treated in the reports of several tax commissions in recent years. While most of these reports commend the theory of an income tax, nearly all of them agree that it is incapable of practical application to the existing economic and political conditions of the American people. This was the conclusion of the Maine commission in 1890 and of the Massachusetts special commission of 1897. The Massachusetts report says: "In the present situation of this country, with our political traditions and business habits, we are of the opinion that an income tax would prove exceedingly difficult to administer with certainty and with equality of treatment as between different taxpayers. . . Here the only possible method is that of declaration by the individual taxpayer, with all its possibilities of concealment, equivocation, false statement, full payment by the honest, evasion by the dishonest, and constant temptation for evasion and false statement for that large class of men neither conspicuously honest nor wilfully dishonest. . . We fear that evasion and concealment would take

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place to so great an extent as to render it ineffective and deservedly unpopular."

The Wisconsin commission of 1898 says: "Unlike the inheritance tax, it is easily evaded, is a temptation to fraud and perjury, and has not generally met with favor in other states." The New York commission of 1902 characterized the tax as "inquisitorial and against the republican spirit," while the majority report of the special commission of 1907 regarded it as "inexpedient and inadvisable." The California commission of 1906 referred to it as inadvisable at the present time, but recommended that the provision be retained in the state constitution for future use if changing conditions justified its adoption.

On the other hand, the Massachusetts commissions of 1875 and 1893, while admitting "a lack of uniformity in its construction and enforcement, and a wide difference of opinion in its worth" recommended that the income tax be retained as a part of the taxing system of the state. The minority report of the Massachusetts commission of 1897 also recommended its retention, while the minority report of the Maryland commission of 1886 and the Pennsylvania commission of 1889 favored the income tax. The Minnesota special commission of 1902 also regarded the tax with favor and held that, if wisely laid "it would not necessarily result in more revenue but in a more equitable distribution of the public burden."

Is an Income Tax Inquisitorial and Undemocratic?

That an income tax, as already stated in this chapter, if capable of practical application, would be the fairest and most equitable tax that could be imposed is now generally admitted. But there is a wide difference of opinion as to how far the state could and should go in providing machinery for the enforcement of such a law. The current objection that an income tax law capable of enforcement would be inquisitorial and undemocratic may have force and yet it would not necessarily be any more inquisitorial than the present federal corporation tax law and many other federal laws which impose either direct or indirect taxes on privileges and business.

The tariff laws are certainly as inquisitorial as an income tax law would be. Not only are you required to make a disclosure of the nature and value of your imports, but on entering an

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American port your very person may be searched if suspected of having dutiable goods not included in your declaration to the collector of customs. The excise tax on spirituous and malt liquors and tobacco involves a searching examination into the private affairs of the distiller, the brewer, and the manufacturer of tobacco. Even the personal property tax laws of our own state require a full disclosure of the kind and value of every item of personal property owned by a citizen of the state and, if strictly enforced, would be almost as inquisitorial as any income tax law would have to be. We are, therefore, not inclined to the opinion that an income tax is necessarily more inquisitorial than many other forms of direct taxation.

Not Successful in Other States

It cannot be denied, however, that the income tax has not been a success in those states that have experimented with it. While this failure is no doubt due in part to the method of self-assessment followed in this country, it is equally true that the neglect and indifference of taxing officials in the enforcement of the law has largely contributed to its failure. The attitude of the taxpayer has also contributed to the failure of the tax. It has never been supported by any strong public sentiment. No law however meritorious in principle will work successfully in practice unless there is a strong public sentiment in favor of its enforcement.

Nature of Income Partly to Blame for Failure

The objection that the nature of income in this country is such as to make evasion of the tax comparatively easy seems borne out by the experience of other states with the income tax. It is doubtful whether the principle of assessing the income at its source could be successfully applied in this state, and as many of our citizens derive a considerable part of their income from investments in other states, the same difficulties in ascertaining the amount of the income would be met with as we now experience in our futile attempt to reach foreign stocks and bonds and other intangible personal property for purposes of taxation. If Professor Cooley's statement that "no means at the command of the government has ever enabled it to arrive with anything like correctness at the incomes of its citizens" is true then an

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income tax would be a failure, because the whole structure is built upon equality of sacrifice and unless every income intended to be taxed can be reached no equality could exist.

Tendency to Evade Taxation

While it is an unfortunate fact, it is nevertheless true that many citizens who should contribute to the support of government exercise their ingenuity in evading the payment of taxes, while many others are equally zealous in concealing as much of their property as possible. This tendency to evasion naturally affects the taxing officials, for they are but a reflex of public sentiment, hence their neglect and indifference in the enforcement of our tax laws. The stream cannot rise higher than its source. Until the public conscience of the average taxpayer can be improved, we fear it is idle to hope for a successful and equitable taxation of incomes. In principle an income tax is the most just and equitable that could be imposed, for it takes from the individual amounts more equitably proportioned to his ability to pay than any other form of taxation yet devised. But in practical application it has not been a success in other states of the Union that have experimented with it, and it is scarcely reasonable to suppose it would be any more successful in Minnesota.

Conclusions

As a result of our investigation we are of the opinion that, under present conditions, and until some other method than that of self-assessment can be devised, and until the development of a stronger public sentiment favorable to the strict enforcement of all tax laws, an income tax in Minnesota would not prove any more equitable or satisfactory than the present personal property tax.

We are not without hope, however, that some equitable method of taxing incomes will yet be devised. Other commissions, as well as many students of taxation, are engaged in the study of the question and are earnestly endeavoring to solve the problem of the equitable and successful taxation of incomes. It will be the policy of this commission to continue its investigation of the subject in the hope that in a future report it may be able to offer more definite suggestions for your consideration.

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STATE INCOME TAXES [1]

The income tax is indeed an admirable tax in abstract theory, but we feel convinced that it will not work in practice in New York. The general property tax is also defensible in theory, but it has been found not to work in practice under American conditions. In the body of the report, the personal property tax is termed ineffectual, and therefore inequitable. The same would, in our opinion, be true of the income tax. It would not work well in practice, and whatever fails to work in practice is indefensible as a legislative proposition. In fact, it is easier to levy a personal property tax than it is to levy an income tax; for some personal property at all events is tangible and visible, while no part of income is ever tangible or visible. The income tax has been tried in many of the American states, and now exists in several commonwealths. It has always been a dismal failure. What reason is there for supposing that what has always been a failure will, at once, become a success? The reason of the failure is to be found in the economic and political conditions of American life. Those conditions cannot be changed by law. They are the same conditions which have made the personal property tax a failure.

The second objection is that which is due to interstate complications. The income tax theory assumes that all the people subject to the tax secure their income in the state, and that all people receiving an income in the state live in the state. Both assumptions are illegitimate. A man may live in New York and get his income from all over the country; or a man may get his income from New York sources and live elsewhere. Any attempt to legislate for the whole country by a New York law must inevitably fail.

Suppose, for instance, that a resident of another state happens to spend several months in New York on a pleasure trip. According to the scheme suggested, he would be subject to a tax on his entire income, irrespective of the question whether he was already being taxed on his income or on his personal property in the state of his residence. This would create an

[1] Report of the Special Tax Commission of the State of New York. 1907. p. 46.

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intolerable situation. Moreover, a man might carry on his business through agents in New York City, and might live in New Jersey or Rhode Island and thus completely escape taxation. Instances of these interstate complications might be multiplied indefinitely and would show how impossible it would be to reach any uniformity of burden by making the income tax a state or local tax. Economic and business life in the United States has become a national life; it has transcended state boundaries. Any attempt by a single state to run against this current is doomed to failure.

The third objection is that of practical inequality. So far as the tax would work at all, it would, in the opinion of your Commissioners, work spasmodically and would produce injustice. The rich man would stand from under, as he does at present with the personal property tax, especially in those states which have a listing system. Either he would live without the state and conduct his business here through agents, or he would so arrange his affairs as to secure most of his income from extra-state sources which could not be reached and which could be so manipulated as not to show in his books. While the aim of the law would be to press less hardly upon the moderate and fairly well-to-do class, the practical result would be, in our opinion, to impose the burden upon these very sections of the community, and to exempt the wealthier classes who can afford to employ the most astute legal talent to aid them in evading the law. The tax would seek to secure equality; it would result in crass inequality.

The fourth objection is that an income tax of the kind recommended would lead to corruption. As is well known, there are two methods of levying an income tax. The one is to assess the recipients of the income directly upon their entire income. This is sometimes called the lump-sum income tax. The other method is to assess the tax, not upon the person who receives the income, but upon the person who pays the income, thus deducting the tax from the amounts payable to the income receiver. This is sometimes called the stoppage-at-source income tax. . . The income tax bill discussed by our colleagues proposes to reintroduce the discredited methods which have never worked well in Anglo-Saxon countries and which have been abandoned as far as possible in England. No one who is at all acquainted with the administrative conditions in

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the United States or with the difference as between Germany and America in the attitude of the average citizen to the administration can entertain much doubt that German methods are inapplicable in this country. We feel that the only result of levying such a direct income tax, resting on the listing of all incomes by the taxpayers, would be precisely as in the case of a rigorous personal property tax, to increase, not equality, but perjury and corruption. The law would either remain a dead letter, as is the case in most of the American states where the income tax is now imposed, or it would tend to create illicit bargains between the taxpayers and the assessors, as is now the case in almost every state of this country where the listing system has been introduced and where great power is given to the assessors in connection with the tax on personal property.

The rich experience of the United States shows conclusively that an income tax of the kind recommended by our colleagues would be ineffective. Even the national income tax, during the Civil War, was a notorious offender in this respect. . . The state income taxes which are found at the present time are mere farces, and there is, in our opinion, no reason to expect much better results in New York. Human nature is about the same in New York as it is everywhere else.

While there is, in our opinion, no doubt as to the inadvisability of an income tax of the kind recommended by our colleagues, the question arises whether a different method of levying and administering the income tax might not remove most of the above objections. As an abstract proposition, again, we do indeed believe that a stoppage-at-source income tax as employed at the present time in England is far preferable to the lump-sum income tax discussed by our colleagues. Even the adoption of the English system, however, would not, in our opinion, completely remove the objections to an income tax.

Our chief doubt arises from the fact that the English system is not applicable to American conditions within the separate states. In England almost everyone who receives dividends or interest on his securities, domestic or foreign, receives them through a banker, who is compelled to make returns to the income-tax board. In America a man keeps his securities in safe deposit vaults, cuts off his coupons and deposits them for collection in a bank, which is, as often as not, situated in

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another state. Bonds, moreover, are not usually registered in the name of the owner, so that it would be almost impossible for a bank or an agency to know whether the person who has so deposited the coupons is the owner or the assignee. Moreover, to the extent that a man's income is derived from foreign corporations—and the great mass of New York incomes is derived in that way—it would be impracticable to reach the foreign agencies or organizations, for a state income tax could not apply to extra-state corporations. In short, looked at from any point of view, the whole system of stoppage at source, as applied to its most important point, namely, the income from intangible securities, would break down almost completely, except in so far as New York corporations are concerned. It is easy to see that the probable result of such a law would be to transfer investments to foreign corporations. . .

In short, we incline to the opinion that even if the income tax is advisable at all, it is advisable at present only as a federal tax. As long as New York is surrounded by commonwealths which seek to attract to themselves much of the wealth of their rival, it is unreasonable to expect a development of interstate comity in taxation which would redound to their disadvantage. Such an interstate comity can probably be forced upon the American commonwealths only from above; and it is a debatable question whether the national government has the constitutional power to do this. At all events, for New York State to act independently in this matter would be, in our opinion, highly inexpedient.

We, therefore, conclude that any form of state income tax is at present inadvisable. Some of the undersigned were years ago in favor of such a scheme, but a closer acquaintance with the administrative and economic conditions of American life has forced them to the conclusion that a state income tax would be a failure. The project is beautiful in fiscal theory, but useless in actual practice. . .

Whatever may be the situation in future years, your Commissioners are convinced that to advance the project of a direct state income tax at the present time is an iridescent dream. The scheme might succeed in bringing in some revenue, but it would, in our opinion, be sure to bring in its train inequality, fraud and corruption. Far from being a remedy for our present evils it would only accentuate those evils.

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It is for these reasons that we consider the imposition at the present time of a direct state income tax inexpedient and inadvisable.

MINORITY REPORT, NEW YORK COMMITTEE [1]

The undersigned members of the Committee appointed under a joint resolution of the Assembly and Senate of the State of New York to examine the laws of this state and of other states relative to taxation, and to investigate into the systems and methods of taxation, particularly with regard to the best methods of equitably and effectually reaching all of the property which should be subject to taxation, herewith submit the following report in which we differ from the conclusions and recommendations arrived at by our colleagues:

* * *

Defects in our System of Taxation

The great fault with our entire system of taxation lies in a lack of centralized administration, and that is due to the origin and growth of our tax system which started from below up, and not from the top down. In other words, our system of taxation both on land and personalty was entirely a local system originating in colonial times, making each town, ward and city an independent tax unit. It is not to be wondered at therefore that there should have been serious difficulties and discrepancies in the various methods of local taxation under which we find real estate assessed in different parts of the state at from 40 per cent to 100 per cent of its value, and personal property either assessed not at all or to a nominal extent. Added to this, and perhaps because of it, we have constitutional provisions which make it difficult to enforce a uniform system of taxation, and even more difficult to impose any new system of state taxation having real or personal property as a base.

State System of Indirect Taxes

It is only since the year 1880 that the State of New York has adopted a centralized system of taxation based largely on corpo-

[1] Minority Report of the Joint Legislative Committee on Taxation. New York. 1916.

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rate franchises, excises and privileges derived from the state, so that notwithstanding the difficulties under which we are laboring, and despite a constitution which to a very large extent fastens this local and decentralized system upon us, with improved laws having a proper and legal base of taxation, enforceable under central authority, we will eventually arrive at a more uniform and logical system of taxation.

Proposed State Income Tax

Now as to the remedy which our associates on the Committee have suggested for the evils of the general property tax system in the form of an income tax, we are by no means in accord. Income means ability to pay, but so does capital, and the latter requires the services and protection of the state more than the former. We know of no great state in the Union which has entirely supplanted its local system of taxing personal property, and its state system of taxing miscellaneous corporations, with a state income tax. The ability to pay theory is not the only theory on which property pays a tax; concessions and privileges from the state, irrespective of income, and property which may be accumulating but yields no income, all of which obtains the protection and services of the state government, have always been a favorite basis on which taxes have been assessed and paid.

Wisconsin State Income Tax. Experience of Massachusetts

Wisconsin is the only state of any importance that has today an income tax enforced with any degree of efficiency, and that supplements rather than takes the place of its personal property tax system. Wisconsin, however, has no classified property tax which we have in New York, from which nearly $50,000,000 of indirect taxes are obtained from personal property. To understand just how much we get from this source we need only make the following tabulation for the fiscal year ending October 1, 1914:

Excises	$9,360,000
Corporations	11,634,000
Organization of corporations	345,000
Transfer Tax	11,162,500
Stock Transfer Tax	2,056,680
Secured Debt Tax	828,619
Mortgages	1,390,746
Motor vehicles	1,528,220

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If we add to this aggregate the excise and mortgage taxes paid to the localities we find that nearly $50,000,000 is derived from the indirect taxation of personal property in the state.

If we correctly understand the recommendations of our colleagues for a state income tax they propose to tax the income from the sources covered by the above taxes, without relieving the owners of the property from the indirect taxes. It seems to us that to tax the income in addition to the property from which it comes is in the nature of double taxation.

It is true that the state of Massachusetts has, through a committee, recommended a modified income tax on securities and interest-bearing certificates, as well as on salaries and professional incomes over $2,000, but the recommendations of the Committee have not been as yet put into the form of law, and the proposed law does not interfere with the taxation of corporations. In both of these states, however, it is to be borne in mind that constitutional amendments have been proposed and carried under which income tax laws could be passed. The courts have generally held that a tax on income is a tax on property. (Pollock v. Farmers' L. & T. Co., 157 U.S. 429; In re Opinion of Massachusetts Justices, 195 Mass. 607.) If so, we are confronted with the objection that under our Home Rule provision of the State Constitution, article 10, section 2, no income tax can be administered except through the local assessors. In the case of People ex rel. Metropolitan Street Railway Co. v. The Tax Commissioners, 174 N.Y. 417; as well as in the later case of People ex rel. Pelham v. Pelham, 215 N.Y. 374, it was clearly held that the functions of the local assessors could not be assumed by, or delegated to, any other officer or body; and it is manifest that if the income tax is not administered by the State Tax Commission or a central board it will be as great a farce as the present personal tax system.

Let us assume, however, that the State Income Tax is constitutional and legal and that such a law could be carried into effect, how would it work? Would it bear on the entire community generally, or would those that were most able to pay escape the burden of the tax?

The following table is taken from the 1914 annual report of the Tax Commission of Wisconsin where under an efficient and centralized administration we find how the tax is distributed and upon whom the burden rests.

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WISCONSIN INCOME TAX

Statistics on Income Taxes for Firms and Individuals—Total for State

Classified by Amount Groups of Income	Number assessed	Per cent of each group to total	Taxable income	Per cent of each group to total	Tax	Per cent of each group to total	Average tax per individual
Total	60,860	100.00	$73,969,905.25	100.00	$1,427,923.13	100.00	$23.46
Under 1,000	41,732	68.57	$15,545,782.60	21.02	$156,202.53	10.94	$3.74
1,000 to 1,999	10,528	17.30	14,004,276.71	18.93	152,871.09	10.71	14.52
2,000 to 2,999	3,855	6.33	9,210,837.07	12.45	110,348.59	7.73	28.62
3,000 to 3,999	1,691	2.78	5,760,689.61	7.79	75,436.33	5.28	44.61
4,000 to 4,999	908	1.49	4,027,847.43	5.44	57,906.82	4.05	63.76
5,000 to 9,999	1,479	2.43	9,820,371.30	13.28	182,901.61	12.81	123.70
10,000 to 14,999	353	0.58	4,245,486.58	5.74	127,168.60	8.91	361.26
15,000 and over	315	0.52	11,354,613.95	15.35	565,087.56	39.57	1,794.00
Classified by Occupation							
Total	60,860	100.00	$73,969,905.25	100.00	$1,427,923.13	100.00	$23.46
Bookkeepers, stenographers and other clerical positions	4,148	6.82	$1,879,911.23	2.54	$20,591.89	1.44	$4.96
Brokers, real estate men, etc.	5,338	8.77	6,451,632.12	8.72	111,334.01	7.80	20.86
Bankers and capitalists	982	1.61	3,523,278.25	4.76	114,267.41	8.00	116.33
Estate—guardianships, etc.	977	1.60	2,779,279.17	3.76	85,417.67	5.98	87.42
Farmers	7,225	11.87	4,730,523.68	6.40	55,314.76	3.87	7.66
Laborers	882	1.45	250,239.80	.34	2,566.07	.18	2.91
Lawyers	1,202	1.97	3,094,198.15	4.18	71,705.54	5.02	59.66
Lumbermen	346	.57	972,899.43	1.32	28,117.76	1.97	81.27
Manufacturers	2,920	4.80	8,405,896.71	11.36	228,512.35	16.01	78.26
Mechanics and tradesmen	5,768	9.48	4,561,101.42	6.17	72,835.65	5.10	12.63
Merchants and jobbers	11,838	19.45	17,419,874.29	23.55	285,686.90	20.01	24.13
Miners	80	.13	130,676.46	.18	3,110.99	.22	38.88
Physicians and surgeons	1,642	2.70	2,443,393.87	3.30	37,404.42	2.62	22.79
Professors and other academic pursuits	2,372	3.90	1,536,905.04	2.08	24,661.31	1.73	10.40
Other professions	2,359	3.88	2,192,295.81	2.96	29,031.79	2.03	12.30
Public officials	555	.91	684,954.35	.93	8,895.51	.62	16.05
State and public employees	1,203	1.98	729,617.31	.99	9,807.12	.69	8.15
Public service employees	2,870	4.72	1,530,814.47	2.07	22,853.03	1.60	7.96
Retired	3,263	5.36	5,126,024.44	6.93	121,513.09	8.51	37.24
Unknown	554	.91	508,864.98	.68	6,488.10	.45	11.71
Other occupations	4,336	7.12	5,017,524.27	6.78	87,807.76	6.15	20.25

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Difficulty of Taxing Non-Residents in New York

Whatever may be the result of the working of the system in Wisconsin, where two-thirds of the total number subject to the income tax pay on incomes of less than $1,000, and the entire income tax, exclusive of the offset derived from the personal property tax, amounts to a little over $2,000,000, we have in the State of New York peculiar conditions which will make it easy for the non-resident or foreign corporation to seek another habitat, or by constitutional or legal reasons to escape the tax entirely. In this state there is a larger aggregation of non-resident wealth and capital than in any other state of the Union. Financially New York city is the capital of the United States, and if our tax system is not made too onerous it may soon be the financial capital of the world. A very large portion of the income earned in this state belongs to non-residents and foreign corporations doing business here. In other words, it has its *situs* or home at the residence of the non-resident, and not within the state. The State of Massachusetts does not seek to subject the income of its non-residents to a tax in its proposed law, which applies only to "inhabitants," nor are we able to ascertain that any effort is made to collect any appreciable part of the tax from the capital of non-residents in the State of Wisconsin. In the face of the decision of the Court of Appeals in The City of New York v. McLean, 170 N.Y. 374, we do not know how it will be possible to collect a tax from non-residents under sections 359 and 360 of the proposed Income Tax Law; nor do we believe it can be done under any State Income Tax Law. If those intended to be subject to the tax under the proposed law are not lucky enough to have a residence out of the state they may turn their property over to foreign corporations who will escape the tax, and in this way New York will devise a tax law for the benefit of the treasuries of her sister states by driving capital out of her own state.

Difficulty of Collecting Income Tax in Wisconsin

Even in the State of Wisconsin, where the public have not yet become educated in methods of tax-dodging, the collection of the income tax has already in the third year of its administration became a serious question, for says the 1914 Report:

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. . . After the delinquent roll comes to the county treasurer, the sheriffs, as a rule, make no earnest or persistent effort to collect. There are marked exceptions, of course. The local treasurers of some municipalities and the sheriffs of some counties do make real and consistent efforts to collect the delinquent taxes. But for the most part the law is a dead letter.

There are reasons, of course, for the existing conditions. Forcible collection of taxes is a disagreeable and unpopular work. The man who respected and obeyed the mandate of the legislature and fully enforced the law would be very likely to lose his office. In some cases the execution of the law would work real hardship. And local treasurers—although paid larger salaries than assessors for a much less onerous and difficult service—are nevertheless probably not paid enough to warrant widespread activity in the collection of the more difficult tax bills. The same is true as to county treasurers and sheriffs when the tax roll reaches them. It is also possible that the law itself is too harsh and should be changed. . .

At present the delinquent tax goes very largely by default and those who are honest pay, while the crafty and recalcitrant escape. That so large a proportion of those subject to personal property and income taxes pay promptly and voluntarily is a tribute to the civic spirit of the average Wisconsin taxpayer.

Can our colleagues believe that fifty years of experience with our personal tax system will make delinquents under their own proposed income tax law less agile in evading the tax-gatherer, or do they rely on the "civic spirit of the average New York taxpayer" to collect delinquent income taxes?

English and United States Income Tax Laws

It is interesting to know from recent reports that in England, which is the original home of the income tax, and where it has flourished for nearly one hundred years, the system in actual practice has been described by a commissioner of internal revenue at an inquiry held some years ago as an "antiquated and haphazard system putting a premium on fraud and enabling the dishonest taxpayer to evade his burden at the expense of the honest taxpayer." If this has occurred in England, what may be expected under the difficulties surrounding our dual system of state and Federal government?

In the United States last year 357,515 persons paid the federal income tax, of whom more than one-fifth were in the state of New York. In other words, about one person out of every two hundred paid an income tax, and we venture to predict that if the exemptions are not lowered and the law remains practically the same, in five years not more than one in every three hundred will pay the tax. As the administrative machinery of the federal government becomes stricter and more inquisitorial the inventive resources of the tax-dodger will become more highly developed in his ability to evade the tax.

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The proposal to levy state taxes on the income of the inhabitants of the State of New York is in conflict with the system of taxation in force for over a hundred years in the United States of America. The course of events in this country discloses a tacit understanding almost inviolate between the Federal government and the governments of the states of the Union, that the states will not levy taxes upon the same subject-matters first appropriated by the United States.

From the foundation of the Federal government it has levied its taxes, by the consent of the people of the states, either at seaports, known as ports of entry, or else by the excise taxes, known as internal revenue taxes; leaving to the states of the Union taxes levied on the property within their several jurisdictions. By a recent amendment to the Federal Constitution the United States is now permitted to tax, and does tax, the incomes of its citizens wherever resident. If the State of New York shall hereafter proceed to tax the incomes of those citizens of New York already paying income taxes to their general government, it will be a violation of the tacit distribution of the taxing powers so long acquiesced in throughout the United States.

In practical operation double taxes upon the same subject-matter, levied by two governments, state and Federal, will create great dissatisfaction among the people of this state. Our people will think, and think rightly to some extent, that they are being subjected to too much government in times of peace. This is always, in all ages, one objection to any federal plan of government. We should not willingly add force to this objection. In times of war our people are patriotic enough to yield, in any manner government sees fit to adopt, all the revenue which either the state or the Federal government needs for the public security or protection. But in times of peace the people of this state will not, we venture to affirm, tamely submit, for a long space of time, to two sets of governmental tax-gatherers demanding taxes from the same sources of revenue. There is no reason at this time, in our judgment, why they should so submit. There are other adequate sources of revenue, besides taxes on the income of our citizens, which are open to the state, and these should be first exhausted before a resort is had to the incomes now subjected to taxation by the Federal authorities.

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Remedies Offered as a Substitute for the Income Tax

Our associates on the Committee propose with one stroke of the pen to take away from the local assessor at least $500,000,000 of taxable property by wiping out the Personal Tax Law. Not content with this they also propose to cripple the State Franchise Tax Law by taking away at least $2,000,000 of the annual tax now imposed on miscellaneous corporations, and there is serious doubt whether this amendment would not endanger at least $10,000,000 of yearly franchise taxes under the correlated sections of the law. The Francise Tax Law of this state has been in operation for nearly thirty years and has been passed on in all its phases by the highest courts of this state, and in its most important features by the Supreme Court of the United States. It provides a revenue of nearly $12,000,000, and with some amendments it could be made to produce a revenue of $25,000,000. So eminent an authority as President Purdy, of the Board of Taxes and Assessments of the City of New York, has said that the Franchise Tax Law, which is capable of a central and uniform administration, could be modeled into a very good statute having all the advantages claimed for the proposed Income Tax Law recommended by our associates, and none of its disadvantages. It would be legal and constitutional, and it could not be evaded by non-resident corporations, and it would bring sufficient revenue to supply in part the needs of the government, and if section 12 of the Tax Law assessing corporations on their capital stock for local purposes were repealed, part of the tax could be distributed to the state and part to the localities.

Amendment of Franchise Tax Law

Partly in line with these suggestions, and partly in conformity with suggestions from the State Tax Commission and the State Comptroller's office, the undersigned have agreed upon certain changes to the present State Corporation Tax Law, amending sections 180, 181, 182, 183 and correlated sections of the Franchise Tax Law. The effect of these amendments, together with the changes in the Inheritance Tax Law, discussed later, with a reasonable return to the localities, in each case, will, in our opinion, result in more "effectually reaching all of the property which should be subject to taxation." If the rates under the franchise tax are increased and section 12 abolished

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the same amount of revenue might be returned to the localities and the evils under section 12 entirely done away with. It will then no longer be possible for a corporation to do business in the City of New York and file its certificate in Esopus or Painted Post, and thus escape taxation.

The following are the principal changes recommended:

Section 180 of the Franchise Tax Law is amended so that no organization tax shall be less than $10, and section 181, relating to the license tax on foreign corporations, is likewise amended so that the same minimum tax be paid by a foreign corporation.

The changes in section 182 make it more intelligible and in harmony with the original intent of the framers. Under the present law there are about fifty thousand corporations who file reports under section 182 of the Tax Law, and about 15 per cent of the entire number pay no tax at all, because either their bonded indebtedness or their general liabilities exceed their assets. About 40 per cent of the remainder pay an average tax of less than $2. Under the proposed law no annual franchise tax shall be less than $10, or less than three-quarters of a mill on the par value of the capital stock. If the actual value of the assets exceeds the par value of the capital stock, or if the market price of the stock exceeds the par value of the capital stock, the tax shall be based on whichever of these valuations shall be highest. If a corporation pays a dividend of more than 3 per cent the tax shall be at the rate of one-quarter of a mill for each per centum of dividend. The basis of valuation has also been changed so as to include the bonds as well as the stock, instead of on the capital stock alone. Two corporations, one with a $1,000,000 of capital stock without any bond issue, should not be treated any differently than a corporation that commences business with $500,000 of capital stock and $500,000 in bonds. From the economic standpoint the capital of both corporations is the same and should be treated alike. In this connection we desire to call attention to an extract from the last report of the State Comptroller:

Your attention is respectfully called to transactions in connection with the reduction of capital stock which seem to be arising somewhat frequently of late, where corporations are seeking to reduce capital, and, as a part of the same adjustment, issue bonds, notes or other obligations in exchange for the retired capital. When corporations proposing to reduce their capital stock have met the requirements of the Stock Corporation Law, the Comptroller, under section 64 of that law, is directed to approve of the reduction. Unless corrective legislation is enacted, this office is

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placed in the apparent position of giving its approval to the subtle stratagems of tax-dodgers.

From the standpoint of public policy of the state, particularly as regards its taxing power, in view of the fact that such action seems to be an effort to transpose the payment of dividends upon stock into the payment of interest upon notes, bonds or other obligations, and thus greatly reduce and perhaps almost entirely evade the tax on franchise imposed under section 182 of the Tax Law, it would seem fitting that an equivalent tax should be levied upon all interest-bearing obligations negotiated in lieu of assessable capital stock.

Manifestly this condition should be remedied and your thoughtful attention is respectfully requested to the end that the state's sources of revenue may not be further endangered.

Exemption of Manufacturing Companies to be Repealed

Section 183 is amended so as to permit the taxation of manufacturing, mining and laundering companies, agricultural and horticulturist associations. There is no reason why these companies should be exempt from state taxation, thus giving them an undue advantage over non-manufacturing corporations, and we believe that the small annual tax required of these corporations will not induce them to move out of the state. The remaining changes that we recommend in the Franchise Tax Law are administrative, and comprehend a more convenient assessment and effective collection of the tax.

We estimate that the proposed changes in the Franchise Tax Law will bring into the treasury of the state additional revenue of about $12,000,000 per year. This is based on a minimum rate of three-quarters of a mill on the par value of the capital stock, irrespective of the higher rates that would be paid by corporations earning a greater dividend than 3 per cent. The figures which we have used in making this estimate are taken from the annual report of the United States Commissioner of Internal Revenue for the year ending June 30, 1914, from which we conclude that the amount of capital stock of New York corporations subject to a franchise tax on said stock would be about $14,000,000,000. At present we receive about $3,500,000 from corporations subject to a franchise tax on capital stock, the remainder being derived from a franchise tax on gross earnings, insurance premiums, and on trust companies, savings banks, etc. We also estimate from the figures presented in the same report that the bonded indebtedness of these corporations would be about $7,000,000,000, which would produce, together with the franchise tax on capital stock, an additional tax in the aggregate of over $12,000,000. If in addition to all this, section

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12 of the Tax Law were repealed, the corporations thereby being relieved from local taxation on personal property, and an additional three-quarters of a mill be added to the tax to supply this deficiency, there would be returned to the localities more than enough to repair the loss.

Apportionment of Taxes

We have already intimated that there is not a sufficient correlation in the system of indirect taxation between the state and localities. True, the mortgage tax and excise tax are apportioned between the state and localities, but this same principle should be extended to the stock transfer tax, the motor vehicle tax and the inheritance tax, and if section 12 of the Tax Law is abolished and the franchise tax extended, there should be an apportionment of the state corporation tax as well. In this way only can the state compensate the localities for the taxes taken away from local assessors and brought under state jurisdiction.

Proposed Amendment to Transfer Tax Law

Three years of practical experience under the amended Transfer Tax Law (Inheritance Tax Law) has shown that the expected increase in taxation by the progressive rates provided in that statute have not produced the anticipated results. The Comptroller in his 1915 annual report makes the following statements:

> . . . The present law has been in force since July 21, 1911, and sufficient time has elapsed to show that the normal annual income therefrom is between $7,000,000 and $9,000,000, which the Comptroller is informed is less than one-half of the income the present statute was expected to produce. For the purpose of comparison the following table shows the number of estates paying a tax within certain stated amounts during the past three years, from which it will be seen that there is only a slight variation in the number of estates paying a tax each year within the limitations set forth at the head of each column:

Estates Paying Tax	$10,000 to $20,000	$20,000 to $50,000	$50,000 to $100,000	$100,000 to $500,000	Over $500,000	Total Estates.	Aggregate tax paid by these estates
1913........	61	50	15	4	2	132	$10,546,461.66
1914........	69	45	13	15	1	143	9,282,193.97
1915........	60	46	18	14	0	138	5,859,097.51

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It is true that the sum of $12,724,236.86 was received in 1913 and $11,162,472.40 in 1914 from this source of revenue, but two estates paid taxes aggregating $5,561,202.56 in 1913, and one estate paid a tax of $2,584,000.00 in 1914, while this year but one estate paid a tax as high as $395,094.06.

The small percentage of estates subject to the graded rates of tax, as shown by the appraisals for the past two years, justifies me in calling to your attention the necessity of reducing both the exemptions allowed on individual transfers, as well as the several limitations beyond which the next higher rate of tax becomes effective, if the state is to receive annually from this source of revenue the amount of tax that the present statute was expected to produce.

* * *

Owing to the present large exemptions almost every estate between $10,000 and $30,000 where the property passes to those in the 1 per cent class is wholly exempt. This amendment eliminates from 25 to 40 per cent of the estates in most of the counties of the state which under the old law would have been taxable.

We recommend, therefore, that the inheritance or transfer tax as it is called be amended in accordance with the last report of the State Comptroller so that the exemptions of $5,000 under section 221 of the Tax Law apply only to father, mother, wife, widow or minor child, and the progressive rates be regarded in accordance with the suggestions made in that report, viz., so that the

1 per cent be limited to individual transfers of $25,000,
2 per cent to the next $75,000,
3 per cent to the next $100,000,
4 per cent over $200,000,

and also that the rates to collateral relatives and strangers be regraded in accordance with said report; and, further, that a tax be imposed on estates of non-residents, such as existed prior to 1911. It is believed that these amendments, which have been suggested by the experience of the Transfer Tax Bureau in the last three years, would bring in additional revenue of about $5,000,000 annually.

Non-Resident Estates

It will be noted that our recommendations as to the tax on non-resident estates is limited to property having an actual *situs* within the state, and to sums invested or capital employed within the state. The courts of this state have clearly defined, both in relation to local taxation as well as to the state franchise tax, what is meant by these terms, and the suggested amendments are therefore not at all theoretical, but can be safely

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followed in practice. In this respect we are steering a middle course between the recommendations of the State Comptroller, who would tax all property of non-residents within the state whether here temporarily or not, and the recommendations of our colleagues in the majority report, that would leave the law as to non-residents in its present shape. We believe that much injustice has been done in the past by taxing all the property of non-residents irrespective of whether it was employed in the state or not, and irrespective of whether it had a *situs* here. In many instances bank accounts belonging to the estates of non-residents were taxed under the old law although such accounts were only here a few days at the time of the death of the testator or intestate. The result was that many large deposits were withdrawn from the banks of this state and re-deposited in the institutions of neighboring states.

Exemptions from Taxation to be Limited

Exemptions from taxation are rapidly becoming a huge and increasing item and the subject deserves the serious attention of the Legislature. In 1907 the total exemptions in the City of New York aggregated over $1,156,000,000, and the total assessed valuation was a little over $6,000,000,000. In 1914 the total exemptions were nearly $1,874,000,000, and the total assessed valuation was a little over $8,400,000,000, or a little more than 22 per cent. Of the $1,874,000,000 of exempt property in 1914 over $1,423,000,000 consisted of city property, and about one-half of this amount consisted of public parks and play grounds. The federal property consisted of a little over $66,000,000, which showed a decrease from previous exemptions. The property of the state amounted to $3,298,000 and also showed a decrease. Of the total amount of exempt property in the City of New York $371,000,000 belongs to religious institutions, asylums, hospitals, private colleges, schools, cemeteries and other private corporations. There is no power in the state government to tax the property of the Federal government, and to tax state or city property would simply mean taking it out of one pocket and putting it into another; therefore our efforts in limiting exemptions must be directed to private exemptions under the general laws. The present easy method of exempting all sorts of institutions, associations and organizations, irrespective of whether the buildings belonging to them are used for charitable, religious or

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educational purposes has been subjected to great abuse, and we think the only effectual way to deal with it is by constitutional amendment, such as that proposed by the recent constitutional convention, requiring a two-thirds vote of all the members elected to both houses before private property could be withdrawn from general taxation. We believe that if this amendment were submitted to the people in a separate measure there would be no difficulty in securing the passage thereof. A mere statutory amendment would not bind any future Legislature and would not have any permanent effect.

Habitation or Occupation Tax

We have said nothing about the habitation tax or occupation tax, which would probably work well in its administrative features applied to metropolitan centers. The weak feature of this tax, we think, would arise from the fact that it would be an additional burden on real estate, and would perhaps, if it were at all onerous, drive tenants from the cities of the state to the suburbs where they would not be subject to such tax.

We do think it would be infinitely preferable to the personal property tax on individuals, and that it would probably work well for cities of the first and second class, provided that the application of the habitation tax were limited on the one end to the well-to-do at a low rate, and graded upward at a very moderate progressive rate so as not to drive any one out of the state. We believe, however, that this change in tax legislation should await the more important state-wide remedies that we have otherwise suggested.

We oppose that part of the habitation or occupation tax scheme known as the salaries tax, on the ground that it is wrong economically and doubtful in its legality. The intent of this part of the plan of taxation was to reach the non-resident salaried class who have no habitation or place of business in the state, but who derive large salaries from employment in the state. Economically this is based on the very narrow view that the employee as well as the employer should pay a tax, although the employer, it will be assumed, has already paid the occupation tax, and the salaried non-resident indirectly contributes more to the state in what he spends than any impost that might be exacted from him. While we have not had time to examine the legal question of taxing salaries of non-residents employed here,

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we believe that there is grave doubt whether such a tax limiting the rights of a non-resident to sell his services within the state would not be contrary to the Constitution of the United States.

Special Franchise Tax

We regret that the time of the committee did not permit a study of the special franchise tax which, in our opinion, is a fruitful field for much needed improvement. Increasing taxes upon public service corporations must ultimately be reflected in the rates for service to the public. Under the court decisions in special franchise tax cases the intricacy of correct assessment is a serious matter for tax administrators. The basis of net earnings, approved by the court, leaves an open door for differences between the corporations and the State Tax Commission resulting in much litigation. A thorough study of this subject might be productive of more scientific methods of assessment. Taxes upon gross earnings at rates varying according to the nature of the public service operation on the one hand, and further classified upon the relation of the gross receipts from all sources to legitimate operating expenses determined by the Public Service Commissions are worthy of thorough investigation and study.

TAXATION IN OKLAHOMA [1]

During the current year the state of Oklahoma, including its various subdivisions, will expend for maintenance of government, including public expenditures for education, for internal improvement, and interest on public debt, approximately $32,000,000. A little more than $29,000,000 of this will be raised by taxation, the remainder being derived from interest on our permanent educational fund and from our public building fund. Some $23,500,000 of this will be raised by the direct ad valorem property tax, and about $3,500,000 will be secured from the tax upon oil and gas production; nearly $1,000,000 from the automobile tax; probably $500,000 or more from the income tax, and the remainder from corporation charter fees, annual license taxes, mortgage filing fees, inheritance taxes, the tax upon

[1] By Campbell Russell. Proceedings Eleventh Annual Conference National Tax Association. 1917. p. 50-5.

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insurance companies, and small sums from various other sources that are of little concern to this conference.

Oklahoma was among the first states to enact income and inheritance tax laws, yet after a ten years' trial they are still of comparatively little importance as revenue producers. Less than ½ of 1 per cent of the taxes collected in our state since these laws were enacted has been derived from the income and inheritance taxes combined. So far as actual results are concerned, we still rely almost wholly upon the direct property tax, designed to apply as uniformly as practicable to all classes of property.

We note that the entire net income from all sources is subject to this tax; also that this tax shall apply to all incomes derived from property owned, and from every business, trade, or profession carried on in this state by persons living elsewhere. Under this law the 1915 tax collected to date is slightly over $250,000, and the 1916 tax collected is a little more than $400,000. The increased collection is partly to be attributed to the fact that until the last legislature met there was no appropriation that the state auditor could use to pay expenses incurred in this work. The difficulty in collecting this tax has been greatly increased by the fact that for six years we had on our statute books an income tax law so viciously unjust in its provisions that practically no attempt at enforcement was made, and the public has been trained to consider the state income tax as largely a donation or free will offering to the state. A very large majority of our people agree that the net income tax law enacted in 1915 is just and equitable and should be enforced. The last legislature appropriated $5,000, payable annually, to be used for this purpose and no complaint is heard from any source that the state auditor has in any way neglected his duty in this matter; yet a few figures will show the remarkably small per cent of this tax actually paid, although the 1916 tax is now long overdue. Clearly no additional collections are to be expected where payment of same can be avoided.

The personal income tax collected by the Federal government from Oklahoma citizens for the year 1916 was $4,428,000. Assuming that an equal amount of this was collected from each of the fourteen steps in the Federal classifications, and then applying to the incomes shown to have been received in each class the income tax rate of the state applicable to each portion,

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we find the state should have collected from these same individuals upon these same incomes the sum of $2,627,572. In addition to this, millions of dollars of Federal income tax were collected from incomes upon property owned and business done in Oklahoma by persons living elsewhere. These collections are not credited to Oklahoma and are not included in the $4,428,000 above set out. Under the state law these incomes are taxable in Oklahoma. No one can do more than estimate what this tax, if collected, would amount to; but inasmuch as a large majority of our oil properties are owned outside the state, and that a very large proportion of our income taxes are secured from this class of business, it is not an unreasonable estimate to say that the tax from this source should equal the amount that as is shown above should have been paid by citizens of the state; but if we include only one-half of this amount, or $1,313,786, we show $3,941,358 as the sum which the state should have collected for the year 1916 upon personal incomes, exclusive of the incomes received as dividends upon corporation stock, the Federal income tax upon which was collected at the source. Oklahoma has no corporation income tax, so that no one is entitled to any reduction on his state income tax for taxes collected at the source. Personal income taxes paid to the state would in many instances be largely increased by the addition to the taxable income of the dividends from corporation stock, the Federal tax upon which has been collected at the source. All things considered, $4,500,000 to $5,000,000 is a conservative estimate of the amount of income tax due the state of Oklahoma for the year 1916. Less than 10 per cent of this amount has been collected.

Oklahoma has collected only a few thousand dollars in income tax from persons residing outside our state and this provision of our law is now being vigorously contested in the Federal court by a citizen of Illinois whose income tax (as per statement rendered by him) due Oklahoma for the year 1916 is over $76,000. This case (testing the constitutionality of this feature of our law) was heard before three district Federal judges in Oklahoma City two weeks ago, and will doubtless go to the Supreme Court of the United States. It seems not unreasonable to anticipate that the government that collects a tax upon the incomes derived from all property owned or business done within its jurisdiction, regardless of the citizenship or

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residence of the owner, will probably sustain the right of each state to collect a tax upon incomes derived from property and business within the state, although the owner may live elsewhere.

Our 1917 legislature placed our income tax rate on the reverse gear, reducing the rate on the smaller incomes 25 per cent; next step, 33⅓ per cent reduction; next, 50 per cent reduction, and the rate on incomes above $100,000 was reduced 60 per cent—from 5 per cent to 2 per cent, which is now our maximum rate. The argument advanced to secure this reduction was not, in the main, that the rate was unjust, but that the reduction was necessary in order to prevent our rich men from removing their residences from our state—assuming that thereby they could escape our state income tax, while still enjoying the profits from the property owned and business carried on within the state. Until our right to collect an income tax from persons living without our jurisdiction has been finally determined, it is hardly proper to include the possible collections from that source in estimating the per cent of the tax actually due which has not been collected; but considering only the amount unquestionably due from citizens of Oklahoma, not more than 15 or 16 per cent of the 1916 tax has been paid. The remedy is contained in one word, *publicity*. So long as the tax collector must play hide-and-seek in the dark with an unwilling taxpayer and must keep secret what he does discover, we may reasonably anticipate that results will continue to fall far below expectations. Personally, I see no good reason why incomes should be kept secret. The man who is able to secure a large income, if it be secured through honest endeavor, should not be ashamed of that fact. However, unless the necessities of war shall change the policy of the Federal government, we may expect the veil of secrecy to continue to screen the income taxpayer (and the income tax-dodger as well) from the public view. It is probable that through concerted efforts upon the part of interested states the Federal authorities may relax their rules sufficiently to permit the proper taxing authorities of a state to inspect the federal income tax records covering that state.

The income tax collected by Oklahoma for the year 1916 exceeds the combined collections of the other seven years, yet the collections for that year do not exceed 1.5 per cent of the total tax collected in the state for such year; these things

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indicate somewhat the immensity of the tax problem. Taxation has long been and to the end of time will be one of the most difficult problems connected with human government.

MINORITY REPORT ASSESSMENT AND TAXATION COMMISSION OF LOUISIANA[1]

The Commission is hopelessly divided on the question of surtaxes and excess profit taxes, the vote being five in favor of surtaxes and excess profit taxes, and four against.

A long argument was made before the Commission that the taxes should be levied according to a man's ability to pay instead of such tax being proportioned to his duty to pay. Without discussing the entire report it is sufficient to quote the following astonishing statement which, if our recollection does not deceive us, was read with approval by the majority of the Commission and inserted by the Chairman and was adopted over the protest of the minority.

> A study of the returns under income tax laws conclusively shows that the income tax is a tax on the rich and well-to-do. The liberal exemptions allowed by the Federal law exclude the great bulk of the population from its operation.
>
> According to the report of the Internal Revenue Department only about ½ of 1 per cent of the population is subject to the tax.
>
> In Wisconsin with lower exemptions, less than 3 per cent of the population come within the law, etc.
>
> Lyons on Income Taxes. p. 43.

Therefore, without going any further, the majority of the commission can be understood as favoring surtaxes and excess profit tax, or, as the majority seem to prefer to designate them, graduated income taxes, because:

1. They are a tax on the rich and well-to-do.

2. Because they exclude the great bulk of the population from its operation.

3. Because under the Federal Income Tax (a tax which should not once be considered, because it was levied to carry the burdens of a great war) only ½ of 1 per cent of the population is subject to the tax.

It is our idea of democracy that the burden of taxation should not be put upon one class of men even if that class of men happen to be rich.

[1] Report of the Louisiana Assessment and Taxation Commission to the Constitutional Convention. 1921. p. 55-60.

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It is not our idea of democracy that the majority of the citizens of the State of Louisiana should welch [sic] on their obligations to the state and allow themselves to be supported by another class of people.

We prefer to think as did our forefathers that there was enough manhood in every citizen of the state for each to bear his share of the burdens of the government.

We believe in an income tax because we believe that the tax can be fairly levied, but we believe that it should be at the same rate for every citizen. We do not believe in heavy exemptions because if we are going to exist as a Republic we should not attempt unjustly to make one class support another. We prefer the simplicity of fairness and justice of our ancestors who had in their minds, hearts and Constitutions the proportionate bearing of the burdens of the state.

In the Constitution of 1845, the following Article covered the right of taxation.

> Taxation shall be equal and uniform throughout the state. After the year 1848, all property on which taxes may be levied in this state shall be taxed in proportion to its value to be ascertained as directed by law. No one species of property shall be taxed higher than another species of property of equal value on which taxes shall be levied.
> The Legislature shall have the power to levy an income tax and to tax all persons pursuing any occupation, trade or profession.

The same article was substantially embodied in the Constitution of 1852.

We still believe that some weight should be given to the character of the men who formulated and prepared these Constitutions for the state. Among these men can be mentioned Mazureau, John R. Grymes, Judah P. Benjamin, Randall Hunt, Pierre Soule, Christian Roselius, Claiborne and other men of like standing, whose characters stand out as beacons of light guiding to freedom and fairness in the conduct of government, who believed in a government "of the people, by the people and for the people"; and such a government cannot exist where ½ of 1 per cent of the population pay the expenses of the state.

The very statement of this proposition will carry resentment to every thoughtful citizen of the state. Not only will it be injurious to the class who are bearing the burden, but it will be more injurious to the men who are avoiding their duties as citizens. What kind of a citizen would we have in Louisiana with such principles announced in the Constitution?

The power of taxation is the most far reaching and danger-

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ous power conferred on the state by the people. As Mr. Justice Miller has said in the case of Loan Association vs. Topeka:

Of all the powers conferred upon Government that of taxation is the most liable to abuse. Given a purpose or object for which taxation may be lawfully used, and the extent of its exercise is, in its very nature unlimited. The power to tax is therefore the strongest, the most pervading, of all the powers of government, reaching directly or indirectly to all classes of people. It was said by Mr. Chief Justice Marshall, in the case of McCulloch vs. Maryland that the power to tax is the power to destroy. A striking instance of the truth of that proposition is seen in the fact that the existing tax of 10 per cent imposed by the United States on the circulation of all other banks than the national banks drove out of existence every state bank of circulation within a year or two after its passage. This power can as readily be employed against one class of individuals and in favor of another so as to ruin the one class and give unlimited wealth and prosperity to the other, if there is no implied limitation of the uses to which the power may be exercised.

To lay with one hand the power of the government on the property of the citizen, and with the other to bestow it upon favored individuals to aid private enterprises and build up private fortunes, is none the less a robbery because it is done under the forms of law and is called taxation. This is not legislation. It is a decree under legislative forms.

Loan Association vs. Topeka, 20 Wall, 655, p. 663-664.

Can anything be stronger than the following sentence in the above citation:

This power can as readily be employed against one class of individuals and in favor of another so as to ruin the one class and give unlimited wealth and prosperity to the other, if there is no implied limitation of the uses to which the power may be exercised.

The undersigned therefore, sincerely hope that the Constitutional Convention will not be led into adopting any such Article as the majority have proposed.

Respectfully submitted,
E. T. Merrick,
J. H. Heinen,
J. R. Perez,
A. M. Smith.

THE INCOME TAX [1]

Although the income tax appears to be receiving from tax commissioners little serious consideration as a practical method, it is deemed pertinent to give a summary of the conclusions arrived at by Delos O. Kinsman in his authoritative work. The Income Tax in the Commonwealths of the United States, 1903.

[1] Civic Federation of Chicago. A summary of the reports of Special State Tax Commissions. 1907. p. 71-4.

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The author studied the income tax in each of the states employing it, dividing its history into two periods: "the first, that of the 'faculty' tax, closed about 1825. It was characterized by a loose method of determining the taxpayer's ability, the levy being made upon an estimated or assumed income of of the individual. The second period, that of the income tax proper, continuing to the present time, has been characterized by the attempt to assess and tax the exact income of the individual. Our study is concerned principally with the second period." A rapid survey of the first period, however, paves the way for a more detailed consideration of the second.

After an examination of the subject by states, and a concise history of the results in each, Mr. Kinsman devotes his last chapter to a *résumé,* from which enough is quoted to make his findings clear;

System Extensively Tried

We shall now give a brief *résumé* before presenting our conclusion. We cannot charge the Commonwealths with slighting the income tax. Of the forty-five states, sixteen have made legislative provision for it, either in a general or special form; of about one hundred constitutions passed by the states, thirteen, representing eight states, have made special provision for its use; and of some forty state tax commissions, which have been appointed by the different states, seven have treated it in their reports.

The use of the income tax proper began about 1840 and has continued to the present time. Its history has been marked by three periods of special activity; one from about 1840 to 1850, during which decade six states introduced the tax; another from 1860 to 1870, during which decade seven introduced it; and a third from about 1895 to the present, which has been marked by a revival of the movement. Of the sixteen states that have employed it, six are still using it—Massachusetts, Virginia, North Carolina, South Carolina, Louisiana, and Tennessee.

Massachusetts has had the longest experience with the tax, extending from 1643 to the present time. South Carolina's experience began in 1701 and, with the exception of about thirty years, has extended to the present. Pennsylvania levied the tax from 1841 to 1871; Maryland, from 1842 to 1850; Virginia, from 1843 to the present; Alabama, from 1843 to about 1886; Florida, from 1845 to 1855; North Carolina, from 1849 to the present time. With but one exception the states introducing the tax between 1860 and 1870 employed it for only very short periods. Missouri employed the tax from 1861 to 1866; Texas, from 1863 to 1868; Georgia from 1863 to 1866; West Virginia during 1863; Louisiana, the one exception, from 1865 to the present time; Kentucky, from 1867 to 1872; Delaware, from 1869 to 1872. Tennessee tried the tax in 1883, but then, like Kentucky, only to a very limited extent. . .

Methods Widely Varied

The states employing the tax have spared neither time nor ingenuity in attempting so to frame the laws as to make the tax effective. Every possible method has been tried. The tax has been levied as a general income tax upon all forms of income and as a special income tax upon one or more forms of income; without regard to the source of the income and modified according to the source; as an apportioned tax, and as a percentage tax. The rate has been made proportional, progressive, and

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partly proportional and partly progressive. The exemption has been a fixed sum applied to all income and a sum varying with the form of income and with particular classes of individuals. The administration of the law has been under the direct supervision of the central government, and it has been left to the option of the local units. The tax has been employed strictly as a war measure, as a peace measure, and as both.

Of all the states using the tax, six have levied it as a general income tax, affecting all forms of income—rent, interest, wages, and profits. These states are Massachusetts, South Carolina, Virginia, Alabama, North Carolina, and Texas. The scope of the tax in Massachusetts, however, has varied with the different local interpretations placed upon the law. The remaining ten states have each taxed some one or more of the four forms of income. All of them except Georgia, Tennessee, and Kentucky have taxed incomes from personal services, salaries being especially mentioned; seven of them, all except Florida, Tennessee, and Kentucky, have taxed profits. Five, Delaware, West Virginia, Kentucky, Tennessee, and Missouri, have taxed interest. The rate of the tax has usually been proportional, although six of the states have made use of the progressive rate.

An exemption has been very generally allowed, varying both in the different states and at different times in the same state. When a fixed sum has been allowed, it has been usually from $300 to $2,500, $500 and $1,000 being the most common amounts. The exemption at present allowed in South Carolina is $2,500. Many of the states have provided for special exemptions, such as the expenses of the business from which the income is derived and the incomes of particular classes of individuals, such as ministers of the gospel, state judges, and certain classes of laborers.

The administration of the tax has been much the same in all the states. It has been assessed, as a rule, by the local assessors and collected by the local tax collectors. The laws have required that the tax should be levied by self-assessment, almost invariably under the severe penalties for failure to comply.

Revenue Insignificant

The revenue derived from the income tax has been insignificantly small. For instance, Alabama in 1882, during the period of her most successful experience, received an income tax of only $22,116, out of a state tax of over $600,000. In 1899 North Carolina's income tax amounted to only $4,399 out of a total tax of $723,307. Virginia in 1899 received only $54,565 from this source, while her state tax amounted to $2,132,368. South Carolina in 1898, while levying a state tax of about $1,000,000, received only $5,190 from her tax upon incomes.

The attitude of the State courts toward the income tax has been one of sympathy. In the few cases upon the subject brought before them they have upheld the tax. Had all forces been as active in support of the system as the state courts, the tax would undoubtedly have been a success. . .

Pronounced a Failure

The experience of the states with the income tax warrants the conclusion that the tax, as employed by them, has been unquestionably a failure. It has satisfied neither the demands for justice nor the need of revenue. The question arises: Is this failure due to qualities inherent in the nature of the tax, or is it the result of conditions which may be removed? One of the fundamental principles of taxation is that the subjects of a state ought to contribute to the support of the government in proportion to their respective abilities, and it is generally agreed that these abilities are best measured by income. Therefore, theoretically at least, an income tax is unquestionably the fairest system yet proposed. Throughout the history of the tax in the several states, the opposition has never seriously attacked it from a theoretical standpoint.

If the failure is to be attributed to the application of the principle, either the laws have failed to embody this principle properly, or the

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administration has been ineffective. While much of the legislation in the states relative to the income tax has been very satisfactory, . . . nevertheless laws have been passed repeatedly which, if properly administered, would have distributed the burdens with unusual justice. But these laws have failed quite as completely as those with provisions less satisfactory. The failure of the tax, therefore, cannot have been due to the ill success of the laws in embodying the principle.

A careful study of the history of the tax leads one to the conclusion that the failure has been due to the administration of the law.

Self-Assessment Always Ineffective

Although the laws have usually required the assessors to demand from each taxpayer a full statement of his income and to enforce their demand by a severe penalty, they have not only failed to do this, but in listing the individual's property have also entirely neglected his income or assessed it so low as to make the tax derived therefrom unimportant. Before we can hope for a successful taxation of incomes, officials must be faithful in the performance of their duty.

Not a little in the way of changing the attitude of the taxpayer toward the income tax may be done by a more careful framing of the laws, so that they will better appeal to his sense of justice. . .

The English income tax has been satisfactory only where assessment at the source has been employed; where it has been necessary to rely on self-assessment, as it has been in one or two classes, the tax has been a failure. The State of Pennsylvania also has employed the method of assessing income at its source with marked success.

The extent to which this method of assessment could be applied to general incomes in this country is uncertain. The Massachusetts tax commission of 1897 considered it practically impossible. With our present industrial organization, much income is derived from sources not accessible and consequently determinable only by the method of self-assessment. Indeed, it would often be very difficult for the taxpayer himself to determine the exact amount of his income; especially is this true of the agricultural classes and, indeed, of a large portion of the business and professional classes. In England industry is carried on in such a way that three-fourths of the income can be taxed with no question or demand of the individual taxpayer; this would be impossible in our states. While the method of assessment at the source can be applied to a few forms of income, and in so far as it is possible to do so the income tax would be successful, still we must also say that with our present system of industry the method could not be applied by our states to a large part of the income received and that, therefore, a general state income tax must be a failure.

BRIEF EXCERPTS

There is no demurrer to the verdict that the state income tax, as it exists (1889) in three commonwealths (Virginia, Massachusetts, and North Carolina) is a mockery. *Winthrop M. Daniels. The Elements of Public Finance. p. 191.*

A federal [i.e. national and state] income tax system necessarily involves multiple taxation on one and the same income, person, and property. *David A. Wells. Theory and Practice of Taxation. p. 533.*

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A state income tax would work just as badly as, and in our opinion even more badly than, the present personal property tax. The real difficulty in the one case as in the other, is not with administrative methods, but with the inherent impossibility of localizing personalty or income. *Edwin R. A. Seligman. The Income Tax. p. 428.*

In the United States income taxes have been employed by both the state and Federal governments. Altogether some sixteen states have imposed this tax at some period of their history, but of these only six continued to use it January 1, 1903. The principal defect in the tax as a state tax is that it is impossible to assess it fairly and that when it is imposed it has a tendency to drive persons with large incomes into other states where no such tax is found. It seems clear from American experience that such a tax must be national in its scope, if it is to be even approximately just in its practical operation. *Henry R. Seager. Introduction to Economics. p. 574.*

A man may live in one state and may secure his income partly from real estate holdings situated in another state and partly from investments in securities of corporations whose earnings are derived in many other states. How is it possible for any local or state administration successfully to ascertain or adequately to control such income of its resident citizens? Most of the state income taxes in the United States are, largely for that reason, the veriest farces, and under present economic conditions are not likely ever to become thoroughly successful. *Edwin R. A. Seligman. Essays in Taxation. Eighth edition. 1913. p. 383.*

The federal government has now added the income tax to its fiscal system. This tax is in all probability to be a permanent feature of our financial system. And the states will, with the further example of Wisconsin's success with a state income tax before their eyes, soon look to this form of tax as offering a practicable remedy for the evils of the personal property tax. The commissioner of internal revenue has all the administrative machinery necessary for determining the size of the individual taxpayer's income. Why should this costly machinery be duplicated? Already the states' tax commissions, boards of

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equalization, and other administrative machinery are high in cost, and low in efficiency. More simplification and less duplication are needed. And this means more cooperation. *James E. Boyle. Annals of the American Academy. 58:63. March 1915.*

The income tax, so far, has been a failure in every state that has adopted it. The main reason lies on the surface. The only way an income tax can be satisfactorily enforced in this country is by taxing the income at its source, on the English plan; and no state has power to do that. A citizen of Wisconsin, for example, may derive a large income from steel stock or New York Central bonds. If he pays a state tax on that income it will be because he chooses to. The state cannot compel a corporation of New Jersey or New York to disclose the dividends and interest it disburses in Wisconsin. Or a Wisconsin capitalist may escape the tax by the simple expedient of taking up residence across the state border. Most of the larger corporations operate in many states and, to avoid an income tax in Wisconsin, can reincorporate elsewhere. A number of corporation removals have been reported already. *Saturday Evening Post. 184:22. June 15, 1912.*

I omitted the income tax because I refer to income tax as entirely unsuited for state revenue. It is practicable, in my judgment, constitutional objections aside, to use the income tax for Federal revenue. The tendency of it is to tax income at source. That means that in every corporation which pays interest on debt, and dividends on its stocks, you must retain a percentage of the dividends and the interest and turn it over to the state. I need not elaborate on the methods of reaching income at source, or the points in the case of the corporation. Four-fifths or above of the revenue from the proposed income tax comes from the income tax reached at the source. It does not depend in the slightest degree upon the good faith of the recipient of the income. You subject the income to the tax before it reaches him. The point of that tax that is reached is the schedule, where they require statements to be made by the recipient of the income. It is impossible from the nature of our state jurisdiction to levy state income taxes at source. *Lawson Purdy. First Annual Conference National Tax Association. p. 93.*

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Many theorists advocate an income tax as the fairest form of taxation. In theory there is much to sustain it. In practice it is almost universally a failure. In theory it seems just that a person should be taxed upon the net yield of his occupation or investments as the best gauge of his taxable ability, but in the levying of such a tax it has always been found that art, subterfuge, evasion, and downright perjury have rendered the system inefficient and futile. To tax capital property, lands, and also the income arising from their employment, is intolerable as double taxation; to exempt such property and rely upon the income from them alone leaves open a hundred ways for evasion, and is open to grave objections. It has been tried in several states, but has proved unsatisfactory in all, and it is a potent argument against this form of taxation that in the efforts that have been made in most states of the Union during the past ten years, to find new sources of revenue, there has been so little disposition to resort to income taxes. *Report of the Special Tax Commission of Maine. p. 36.*

Examination of these various laws shows a lack of uniformity which is deplorable. There are many instances of double taxation. That more protest against double taxation has not been heard is largely due to the fact that the states having income tax laws are not contiguous. When adjoining states pass income tax laws having the same diversity and variety marking present legislation, the situation becomes one for serious consideration.

If we are to take as a criterion the legislation on income taxation already enacted and the legislation of the different states on inheritance taxation, it is futile to hope for very much uniformity in income taxation for many years to come. There must be concerted action, however, to prevent double, perhaps triple or quadruple, taxation of the same income. The laws already enacted plainly show that nearly all state legislatures are loath to permit non-residents to go untaxed on income received within their state borders. There is also a strong tendency to tax residents on all income received from intangibles regardless of the source. *Frank D. Strader. Proceedings National Tax Association. V. 13.*

From the point of view of revenue produced the income taxes have been of little importance and, where retained, have become

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almost a farce. This small yield is partly explained by the special character of the taxes imposed. It is partly explained by careless administration or failure to enforce the law. And this failure to enforce the law has been due, to an extent, to the fact that the taxes have frequently been regarded as class taxes, but more to the fact that their administration has been incidental to the work of local officials while the revenue was to be paid over to the state treasuries. And finally, where an honest effort has been made to enforce the law, the opportunities for evasion have proven too difficult to overcome.

The state income taxes have been little better than failures in practice, and slight improvement can be expected so long as we rely upon the personal declarations of taxpayers in making assessments. Our experience with federal and state income taxes lends no hope that under ordinary circumstances can an income tax be made satisfactory unless by getting at the greater part of incomes before they come into the hands of the individuals who bear the tax burden. But unfortunately, in state and local income assessment, especially if the taxes are supplementary to property and corporation taxes, this cannot be done to any great extent. State and local income taxes are not at present practicable measures. *H. A. Millis. First Annual Conference National Tax Association. p. 444-5.*

The income tax, although advocated by good authority, seems to be more proper as a special or supplemental tax, where other sources of revenue fail, or for special demands like war.

It is open to three objections: First that it is extremely difficult to collect fairly—so much so that in Germany, where that tax is laid, the proverb runs, "The bigger the income, the bigger the thief." It is a tax which is more readily evaded by the very rich than by any others, because it pays a rich man to employ the best counsel, to resort to legal artifices, or to remove his residence for the purpose of saving a considerable sum of money, while upon the man of moderate circumstances, especially those on a salary or having a fairly definite professional income, it falls with redoubled weight.

Secondly, even a graduated tax has not that justice which appears on its face. For a poor man with a large family to pay anything out of an income which barely supports him is more of a hardship than for a wealthy man, who has only himself to care for, to pay a large proportion out of his superfluity. In

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order to impose anything like equal burdens, an income tax should be graduated with reference not only to the amount of income, but to the amount of necessary expenditures, and consequently with reference also to the social position of the individual. Thus a butcher's foreman with $1,500 a year who lives as butcher's foreman and men of the laboring class usually do, would find a tax upon his income far less burdensome than the small merchant who makes $1500 profit, but whose mode of living and dress, from the nature of his occupation, necessarily involves a much larger expenditure. But such graduation would be impossible.

Thirdly, an income tax is paid, if paid at all, entirely out of savings. It tends to discourage frugality, and to undo the very work on which we have spent so much trouble in establishing, a savings bank system. All proposals for a graduated income tax necessarily provide for the exemption of incomes under a certain amount, for it would not pay to collect a tax on a laborer's wages. If, in order to remedy this, its payment be made a condition, it opens a wide door for corruption; and, if not so constructed, such a system would exempt the greater part of the public from all share in the public burdens.

"It is to be feared therefore that the fairness which belongs to the principle of an income tax cannot be made to attach to it in practice." *Bolton Hall. Public Opinion. 13:53. April 23, 1892.*

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